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A NATIONAL POVERTY REDUCTION STRATEGY AND THE ROLE OF DONORS

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Social Policy and Development Centre

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A NATIONAL POVERTY REDUCTION STRATEGY AND THE ROLE OF DONORS

The return of (rapidly increasing) poverty in Pakistan during the 1990s is increasingly being recognised by government and civil society at large as the principal problem requiring urgent attention if a large-scale social breakdown is to be averted, with its concomitant implications on law and order. The objective of this paper is to present the key elements of a comprehensive poverty reduction strategy which goes considerably beyond the poverty alleviation programme recently announced by the government.

1. THE POOR

Research at the Social Policy and Development Centre (SPDC) has identified the nature, extent, and profile of poverty in Pakistan. Some of our principal findings are:

- Today, almost one third of the population is poor. This means that currently 46 million people in Pakistan live below the poverty line;[1]

- Poverty incidence has increased sharply during the decade of the 90s. At the beginning of the decade one in five families was poor, it is now one in three families;

- Poverty varies substantially among regions of Pakistan. It is significantly higher in the rural areas. Pockets of extreme poverty, with one in every two families being poor, are to be found in the rural parts of Sindh and Balochistan;

- Poverty is concentrated in large families with few earners and high dependency ratios; in households where the head is illiterate or with only primary education and is either unemployed or underemployed; in female-headed households; and in households which either do not own assets like property, land or livestock or, have access to transfers;

- In rural areas, ownership of land or livestock has the biggest potential of taking households out of poverty while in urban areas access to employment and acquisition of skills/education make the largest contributions to alleviating poverty;

[1] Estimated currently at between Rs 2800 to Rs 4700 per month for a household of six members, depending upon location. These estimates have been arrived at by increasing the poverty line estimates for 1996-97 by the cumulative increase in the consumer price index (CPI) between 1996-97 and 1999-2000.

- Much of the poverty is chronic in nature, with almost 70 percent of the poor households consisting of households where the head is either illiterate, old or, a female;
- Overall human poverty, in terms of access also to basic education and health services, is even more pronounced than income poverty.

These findings highlight the structural dimensions of poverty in Pakistan and indicate that the poverty reduction strategy will have to be comprehensive and multi-dimensional in character.

We have also explored the role played by the informal economy of Pakistan in mitigating poverty, that is, whether it acts as a residual employer and provides sufficient income earning opportunities, especially to unskilled and illiterate workers. While there is evidence that employment growth in the informal economy is counter-cyclical with respect to the formal economy, it appears that growth in value-added and incomes is pro-cyclical in character. This implies that during periods of recession in the economy, as in the late 90s, while employment remains stagnant or falls in the formal economy it does increase relatively rapidly in the informal economy but at the cost of falling labour productivity and incomes, which causes higher poverty. Therefore, there are no grounds for complacency and optimism about the growth-preserving and poverty-reducing role of the informal economy.

We also ask the question: To what extent are people able to cope with poverty through an informal and household, or community-based welfare and support system of intra- and inter-household transfers to the poor?

Our research on informal transfers leads to the following conclusions:

- Such transfers are indeed sizeable at about Rs 100 billion currently[2], aggregating to over 3 percent of the GDP, with almost two thirds reaching poor families. They are over five times the total of public transfers;

- Bulk of these transfers are in the form of remittances from within Pakistan or from outside Pakistan;

[2]Based on extrapolation of estimates for 1996-97 to 1999-2000.

- Almost three million households receive transfers in one form or the other at an average of about Rs 2500 monthly per household. Half of these households are able to rise above the poverty line due to these transfers.

Therefore, people have found ways of fighting poverty by helping each other. Their efforts have meant significant reduction in poverty (by about one fifth). There is, in fact, a strong nexus between migration (both domestic and abroad), home remittances and poverty. But because of the loss of growth momentum in recent years, the ability of the informal economy, in particular, to absorb migrants from rural areas has diminished, while migration to the Middle East has, more or less, ceased. Therefore, the role of migration and remittances, thereof, in alleviating poverty is bound to become more limited.

2. THE POVERTY REDUCTION STRATEGY

Given the wide and growing prevalence of poverty in Pakistan and the increasing inability of people to organise and provide for themselves in the fight against poverty, it is clear that the government has to step in now in a big way by aggressively pursuing and with strong commitment the implementation of a national poverty reduction strategy. What should be the salient features of such a strategy?

We believe that fundamentally a three-pronged poverty reduction strategy will have to be adopted, consisting of, first, increased economic opportunities for the poor, second, their empowerment and, third, access to welfare and support through development of appropriate social safety nets. Chart 1.1 gives a schematic representation of the elements of the poverty reduction strategy recommended by us for Pakistan. The recent World Development Report [2000/2001] has emphasised similar elements of a global strategy for poverty reduction.

The three major elements of the recommended poverty alleviation strategy support and reinforce each other. Creation of economic opportunities alone will not sufficiently alleviate poverty unless people have the necessary human capital endowments to avail of the opportunities or are adequately empowered to ensure that the benefits of growth are not largely pre-empted by the rich. Expansion of social services (as, for example, in the Social Action Programme) will not contribute much to poverty reduction unless employment opportunities exist for utilization of the higher levels of education and skills.

3. OPPORTUNITIES

Our basic contention is that while social safety nets can begin to mitigate against the worst manifestations of poverty, the country's overall poverty outcome hinges on broader macroeconomic developments relating to such key poverty determinants as growth in real per capita income and the level of employment. In fact, the decline in poverty in the 80s and its increase in the 90s largely has a macroeconomic explanation. In the 80s, per capita income increased rapidly, the rate of unemployment remained low and the human capital endowment of the labour force improved significantly. As opposed to this, the 90s witnessed slow growth in per capita income and actual stagnation in the second half of the decade. Simultaneously, unemployment increased appreciably. By 1996-97, new entrants to the labour force, including young educated workers, were having great difficulty in finding a job; over 40 percent remained unemployed even after more than one year of searching for a job. The poverty problem was further exacerbated by the rapid increase in food prices and the steep fall in home remittances.

3.1 Macroeconomic Strategy

It is clear that if the increase in poverty is to be contained during the current decade then the environment of economic opportunities for the poor will have to improve dramatically. The economy will need to show more dynamism with faster growth leading to more labour absorption and increase in incomes. A strategy for the revival of the economy must, therefore, be central in any national programme for poverty alleviation. Constraints to economic revival include the following:

Low and falling investment and savings. The level of investment in Pakistan has fallen by almost 5 percent of the GDP from the peak attained in the early 90s. Much of the decline is in public investment. Rising debt and interest payments, coupled with the pressure to contain fiscal deficits (as part of the ongoing IMF programmes) have increasingly crowded out allocations for development from the budget. The decline in private investment is more recent in character and has occurred as a consequence of diminished confidence due to the draconian measures taken in the aftermath of the sanctions imposed on Pakistan following the nuclear blasts. Foreign investment, in particular, has become very shy because of imposition of capital controls and lack of resolution of the Independent Power Producers (IPP) issue.

The level of national savings has fallen to only 12 percent of the GDP. Public savings have turned negative due to the emergence of large revenue deficits caused primarily by rising interest payments. Private savings have remained stagnant because of the lack of growth in real per capita incomes.

Lack of Foreign Savings. Foreign savings have traditionally been a major source of financing investment in Pakistan, especially during the decade of the 80s. But net capital inflows have diminished in the 90s due to a worsening of the aid environment and rapid increase in external debt servicing liabilities. Following the freezing of Foreign Currency Accounts (FCAs) and a major fall in Pakistan's credit rating, capital inflows have dried up. For sustainability of the balance of payments position, the current account deficit (equivalent to foreign savings) will now have to be restricted, especially in light of the precariously low level of foreign exchange reserves.

Declining Efficiency of Capital. The problem of low and falling investment has been exacerbated by the declining efficiency of capital in the economy, whereby more investment is now required to achieve the same growth. Stagnant factor productivity, wrong investment choices and growing problems of wastage and corruption have all implied a rise in the capital-output ratio in the economy.

Stagnant Manufacturing Sector. A number of factors have contributed to the sluggish performance of the manufacturing sector in the 90s including unfavourable demand conditions at home and abroad. Manufactured exports have stagnated since 1994-95. Second, the production base has been eroded by smuggling and the ongoing process of trade liberalisation. Third, the liquidity problems of Water and Power Development Authority (WAPDA) and the fall in the overall level of investment have led to major declines in output of engineering industries. Fourth, the increasing tax burden has restricted output in a number of major consumer goods industries.

Other factors which have contributed to the sluggish growth in the 90s include the crisis of institutions and especially the decline in the quality of economic governance, loss of sovereignty arising from the need to implement conditionalities embodied in IMF programmes which have focused primarily on macroeconomic stabilisation and created recessionary conditions, inability of the economy to adjust to the process of globalisation and the presence of poor social indicators which have implied low levels of human resource development and restricted the scope for increases in productivity.

Based on the above, the macro elements of a revival strategy for Pakistan's economy will include restoring investor confidence, bringing down real interest rates, enhancing the level of development expenditure, maintaining real effective exchange rate stability and broad-basing the tax system. Primary emphasis will have to be placed on faster growth of the manufacturing sector and of exports.

For Pakistan to get back to a relatively high growth path in the medium run, the following will be essential:

- Removal of the binding constraint of shortage of foreign exchange for external debt repayment by access to significant new concessional financing from donors and a second round of debt relief;

- Restoration of investor confidence by removal of capital controls, attractive investment and privatisation policies, settlement of the long standing IPP dispute, and stable and consistent economic policies;

- Reduction in current expenditure by 1.5 percent of the GDP, through containment of the costs of administration by right sizing and austerity, allocations for defence expenditure beyond 2000-01 indexed to inflation, and a fall in interest payments in relation to the GDP;

- Fall in real interest rates brought about by fiscal deficit reduction and domestic debt retirement, facilitated by debt relief and privatisation proceeds;

- Aggressive policies for resource mobilisation, leading to an increase in the overall tax-to-GDP ratio of almost 3 percent by 2002-03. This can be achieved by effective broad-basing of the tax system, greater documentation of the economy which reduces tax evasion, major tax reforms which lead to simplification of the tax system and fundamental improvements in tax administration;

- Increase in development expenditure from 3 to 5 percent of the GDP by 2002-03, inclusive of a labour intensive public works program which creates an additional 0.5 to 1 million jobs.

Therefore, if the above reform agenda is implemented and targets are met, the economy can once again achieve a growth rate of 6 percent by 2002-03, with the unemployment rate falling from 7 percent currently to below 5 percent. Simultaneously, macroeconomic stability can be enhanced with the current account deficit in the balance of payments falling below 1 percent of the GDP and the budget deficit being contained to 3.5 percent. Consequently, the rate of inflation could fall from the projected rate of 7 percent in 2000-01 to 5 percent by 2002-03. The resulting rapid increase in real per capita income (of over 3 percent) and the expansion in employment opportunities imply that by 2002-03 the increase in incidence of poverty will be arrested.

But, it needs to be emphasised, that if Pakistan's economy remains trapped in a low growth path, as in the second half of the 90s, then there is every prospect of an exponential increase in the number of the poor. In particular, if the country is compelled to make a sharp balance of payments adjustment in the short run due to severe shortage of foreign exchange reserves, then it is conceivable that an additional 15 million people could fall below the poverty line in the next three years.

3.2 Sectoral Growth Strategy

There is also increasing recognition now that stimulatory fiscal and monetary policies for raising aggregate demand and providing more economic opportunities for employment and income generation will need to be combined with a sectoral focus involving supply-side measures in order to achieve the fastest and maximum results with regard to economic revival. This will involve development of the appropriate set of policies, improved institutional arrangements and regulatory framework to incentivize the chosen sectors and increase their dynamism.

In the Economic Revival Plan announced by the Chief Executive of Pakistan, the following areas have been chosen as the key micro elements of the government's revival strategy:

- revitalising the agricultural sector (primarily major crops);
- promoting small and medium enterprises;
- encouraging oil and gas exploration and development;
- developing the information technology and software industry

We recommend the use of a number of criteria for identifying sectors which can expeditiously and effectively lead the process of revival. These are high labour intensity, presence of backward and forward linkages, low import intensity, low requirements of foreign investment and technology, high contribution to tax revenues and limited requirements for policy reforms and infrastructure. In order to maximise the prospects for pro-poor growth, primary emphasis will have to be placed on inducing rapid growth in those sectors that, first, are labour intensive in character and, second, produce goods and services that have a relatively high weight in the consumption basket of low income groups.

Based on application of the above criteria we identify construction, livestock, minor crops (especially coarse foodgrains, pulses and vegetables) and agro-processing as sectors which should also be targeted as key sectors in the revival process in order to further, at the micro level, the goal of poverty reduction as a complement to the macro strategy for economic revival.

4. EMPOWERMENT

A key element in any national poverty reduction strategy is empowerment of the poor. We see the process of empowerment as consisting of, first, enhancing the ownership of physical assets like land, property, livestock, etc., in order to improve the prospects of the poor being able to generate secure, sustainable and adequate livelihoods, second, augmenting human capital endowments through improved access to education and health services so as to give people the ability to get out of the poverty trap by exploiting better whatever economic opportunities become available, and, third, moving towards pro-poor governance through changes in the political system, state institutions and laws which promote decentralisation and participation of the people thereby enabling the voices of the poor to be heard in the forums of policy making.

4.1 Asset Redistribution

Land

We propose that land reform must be included as a prime instrument for eliminating rural poverty in Pakistan. This proposal rests on two key stylised facts about the nature and dimensions of rural poverty in Pakistan. First, rural poverty is high because rural income inequality is high, and rural inequality is high because of the very skewed distribution of land ownership in the country. Second, the incidence of poverty is high among the rural landless, and access to land takes a high proportion of households out of the poverty trap.

Ownership of land, in situations where rural markets are incomplete and interlocked in character, can make a significant contribution to the food security and nutritional well-being of households, as well as to their ability to withstand shocks. For example, the obstacle of collateral for access to credit is removed through entitlement of land. The political economy implications of land reform are also important. Land reform could virtually herald a revolution in the countryside and would probably constitute the single most significant act of empowerment of the poor in Pakistan. Empirical research in Pakistan also demonstrates that efficiency losses due to land reform are likely to be marginal.

The previous two land reforms, in 1959 and 1972, were both promulgated by the use of martial law regulations. Therefore, the initiative for land reforms has been taken under military governments or with the help of strong provisions under martial law. Pakistan today has a military government, which at least in its initial statements seemed inclined to consider another land reform. The big challenge and true test of the commitment of the present government to the objective of poverty reduction is if it can muster up enough will to implement deep and meaningful land reforms.

4.2 Governance

Poverty is the outcome of interactions between economic, social, legal and political processes, mediated through a range of institutions. The extent to which state institutions can be considered as pro-poor is determined by the quality of governance and democracy, the rule of law and the extent to which there is both political decentralisation and participation of the people.

Political System

The first issue, which has acquired contemporary relevance in the Pakistan context, relates to which system is more pro-poor - parliamentary democracy or an authoritarian military regime. Pakistan is, in fact, unique in the sense that, historically, democracy has been interspersed with long periods of military intervention. Analysis of the track record reveals that the rate of poverty reduction has been, more or less, the same under both types of government. It appears that while economic growth has been slower under democratic governments, these governments have generally achieved more pro-poor growth.

What explains the apparent concern for poverty on the part of the present military government? First, we believe that, in the face of rapidly rising poverty, the military regime has been compelled to focus on poverty alleviation, largely as a reflection of the enlightened self-interest of the elite in averting a social breakdown in the country. Second, in search for legitimacy, the military government has probably found in poverty reduction a viable populist slogan. Third, the regime may be catering to international donors' new found concern for poverty alleviation, in an effort to attract more concessional assistance.

As Pakistan gears up to return to democracy by late 2002, the question is whether this momentum for state intervention in poverty alleviation will be sustained or not. The answer hinges on whether the imperfect democracy that Pakistan has experienced to date can be improved upon. True democracy will require a shift from personalized leadership to a more effective operation of institutions, particularly the legislative and judicial arms of government. An impartial and autonomous accountability mechanism will have to be put in place to prevent the worst excesses of politicians. The political environment will also have to be made more conducive to the development of NGOs and civil society at large, through the protection of civil liberties and freedom, including the preservation of press freedom.

Rule of Law

The rule of law is of vital importance to the poor. The interests of the poor can be subverted either by the absence of equitable laws or the presence of inherently inequitable laws (such as those relating to property rights or the treatment of minorities and women) or by the inequitable application and enforcement of existing laws. More broadly speaking, a proper legal system should promote stable and higher economic growth while respecting property rights, guaranteeing the sanctity of contracts, and lowering transaction costs.

In Pakistan, the existing judicial system has lost the confidence of the people, especially of the disadvantaged and the underprivileged. There is a massive backlog of court causes still pending, and the subordinate judiciary, which interacts most with the poor, is seen to be corrupt, prone to political interference, inadequately trained, and underpaid. The lack of justice, which is a common complaint of the people, is a significant contributing factor to their state of permanent deprivation.

Judicial reform will have to focus on the following: (1) poor governance and administration, (2) inadequate case management and long delays (3) lack of automation and court information systems (4) poorly developed human resources and (5) absence of infrastructure. Various legal aid systems for the poor will have to be established.

Institutions

In the context of improved economic governance, policies will have to be increasingly motivated by the objective of protecting the public interest or, more particularly, the poor, while becoming less vulnerable to the pressures of powerful special interest groups. For this to happen, the process of policy making will have to be opened up and made more transparent; information systems will have to be linked more closely to ground realities and, the bureaucracy will have to be made more responsive and accountable.

Administrative capacity and capability are important components of good governance. By impacting on the quality of public service delivery, they directly raise the well-being of the poor. Merit-based recruitment and promotion linked to performance, market-based wages and autonomy from the political process, are perhaps the most crucial elements of improved bureaucratic performance. Civil service reforms in Pakistan will have to focus on decentralising the organisational structure, simplifying rules of business, modernising management practices, changing the skills mix, enhancing in-service training, increasing accountability, promoting coordination among cadres and improving recruitment procedures.

Anti-Corruption Measures

Elimination of corruption is of fundamental importance in the improvement of governance. Today, corruption is deeply entrenched in Pakistan and threatens the entire economic, political and social fabric of the country. Petty corruption is widespread, mostly carried out by low-level personnel in the performance of some regulatory function or in the provision of some service. The poor are especially vulnerable to petty corruption in the conduct of their day-to-day activities.

The rise in petty corruption is a reflection of the systemic nature of corruption. It has been reinforced by falling real incomes of public officials, the emergence of shortages in basic services and higher user charges. The time has come to take strong symbolic steps to reduce corruption. The government must set up an impartial and all encompassing accountability mechanism and give examplery punishments to corrupt officials of public utilities, law enforcing agencies and the lower judiciary.

Devolution

Decentralization and devolution can be powerful ways of empowering the poor especially if this leads to greater community involvement in the delivery of services and social safety nets based on local needs, local accountability and local monitoring. The government has announced an ambitious plan for the devolution of power to local governments within the country. Implementation of the devolution plan by mid-2001 will represent a fundamental change in the system of government in Pakistan.

This plan has a number of positive features like greater accountability of local officials, enhanced scope for representation of the underprivileged through reserved seats and non-party based elections. But the plan also has major risks, including the lack of institutional capacity to handle the diverse set of functions being handed over, reluctance of provincial governments to fully empower local governments, unclear financial arrangements and the likelihood of capture by local elites, which could defeat the purpose of inducing greater peoples' participation.

4.3 Service Provision

Services can contribute to alleviating poverty in a number of ways. First, by building up the human capital endowments of the poor, services can better equip them to earn a living. Second, services can enhance income and employment opportunities by strengthening the public infrastructure for private investment and growth. Third, they can help reduce private consumption expenditure and thereby enable an improvement in the living standards of the poor.

Pro-Poor Social Services

The decade of the 90s has witnessed the large and growing gaps in coverage of basic pro-poor services like primary education, curative and preventive health care, population welfare, water supply and sanitation, etc. This is the consequence of a large-scale retreat by federal and provincial governments from the provision of such services, especially in the second half of the decade, reflected in the sharp fall in public expenditure on social services. From a peak of 4.1 percent of the GDP in 1995-96 it has fallen to 3.4 percent in 1999-2000. Education expenditure during this period has fallen from 2.5 percent to 2.1 percent of the GDP. Cutbacks in development expenditure, in particular, have been steep and the gaps in coverage have acquired a permanent and increasing character. For example, the number of new schools constructed is now down to one fifth and hospital beds to one fourth of the peak rate attained in the first half of the 90s.

We believe that in an environment of resource limitations and changing priorities, expansion in coverage of pro-poor services will have to come through higher efficiency and greater cost effectiveness. Beyond getting more value for money, the government will also have to demonstrate its commitment to poverty reduction by diverting more resources for upgrading and expanding the coverage of pro-poor services. The federal government must target to ensure through direct spendings and transfers to provinces that at least 20 percent of public expenditure goes to social services.

Social Action Programme

The Social Action Programme appears to be in jeopardy. Results of the large outlays under this programme in terms of the impact on social indicators have been somewhat disappointing. In recent years, the programme has been scaled down significantly by provincial governments. Reforms urgently required in SAP include the following:

- Better prioritisation, which leads to the identification of core pro-poor social services that must remain protected from cutbacks;
- Institutional reforms that imply greater decentralisation and involvement of beneficiaries;
- Changes in delivery mechanisms that enhance cost effectiveness, sustainability and impact;
- Greater involvement of NGOs and the private sector through evolution of public-private partnerships and appropriate regulation;
- Use of independent and effective monitoring and evaluation systems.

5. WELFARE

The third plank of a poverty reduction strategy relates to welfare measures which can largely target the poor. This includes economic reforms in the areas of public expenditure, taxation and pricing policy and the development of social safety nets which reach out especially to the hard core poor, who are unable to avail of economic opportunities and the process of empowerment.

5.1 Fiscal Reforms

Public Expenditure Reform

Public expenditure reform has proven to be one of the most intractable areas of reform. As highlighted above, the key task is to orient the benefits of public expenditure increasingly towards the poor. The currently misplaced priorities of public expenditure are starkly highlighted by the following:

! Military expenditure remains at an unsustainably high level in Pakistan at close to 4.5 percent of the GDP. It is more than twice the total expenditure on public education;

! Subsidies on economic, social and community services added up to over Rs 145 billion in 1997-98, equivalent to 5 percent of the GDP. They have risen from about 3 percent of the GDP in 1980-81 and 4 percent of the GDP in 1990-91. The share in subsidies of merit goods (that is, primary education and health) is relatively small, at about one third. The rest goes primarily to economic services (like irrigation) and higher education which largely benefit the rich;

! The pressure to contain fiscal deficits has led to sharp cutbacks in development expenditure, which has fallen from over 7 percent of the GDP in the early 90s to only 3 percent of the GDP by 1999-2000. As indicated earlier, this has severely restricted the rate of expansion in the coverage of pro-poor social and economic services.

Making public expenditure more responsive to the needs of the poor will require, first, enhancing user charges for services that primarily benefit upper income households and then using the revenues generated for cross-transfer payments to the poor, second, placing a limit on the increase in military expenditure and exercising cost savings wherever possible; third, rethinking the role of government and downsizing in areas of low priority; fourth, improving transparency and accountability of expenditures by setting up proper oversight bodies and disseminating more information on budgets, fifth, restructuring public sector institutions and service delivery, and, sixth, integrating planning and budgeting in a medium term framework so as to enhance the financial sustainability of services provided.

Tax Reform

From the viewpoint of poverty alleviation, tax reform is important for two basic reasons. First, to the extent possible, such reform must attempt to reduce the burden of taxes on those goods and services that are consumed more by the poorer segments of society, and shift the incidence to the incomes and consumption of relatively well-off households. Second, given the low and falling tax-to-GDP ratio of Pakistan, the government has found it increasingly difficult to increase the levels of public expenditure on what can be considered pro-poor services, and to expand the outreach of social safety nets. Therefore, it is imperative that the tax-to-GDP ratio be raised, but not in ways that adversely affect the poor. The additional revenues should be used to the extent possible for financing the poverty alleviation programme.

Pakistan's current tax system manifests all the characteristics of a failed system - absence of a tax culture, high levels of tax evasion, weak and antiquated tax administration, a defective tax policy that has been exploited by special interests for wide-ranging tax concessions and exemptions, and an overreliance on indirect taxation.

This has implied the following:

- A falling tax-to-GDP ratio, especially in the second half of the 90s. Today, this ratio for Pakistan is below 13 percent whereas the average for developing countries at a comparable stage of development is 20 percent;

- The size of the black economy of Pakistan is estimated at close to Rs 800 billion in 1998-99, equivalent to about one fourth of the economy. This represents a revenue loss due to tax evasion of almost Rs 105 billion, equivalent to over 3 percent of the GDP;

- Tax expenditures (representing the revenue foregone due to tax concessions and exemptions) are rampant and add up to Rs 120 billion, equivalent to as much as 40 percent of the revenues actually collected. A large proportion of these tax expenditures (especially in direct taxes) largely benefit the rich;

- The tax burden has become more regressive with the recent increase in the share of indirect taxes and increasing reliance on taxation of energy inputs into consumption and production.

The primary thrust of tax reforms has to be on raising the tax-to-GDP ratio while simultaneously reducing the burden on the poor and raising it on the rich. It appears in fact, that if tax evasion and tax concessions or exemptions to the rich could be eliminated then Pakistan's tax-to-GDP ratio could approach the developing country average.

Elimination of tax evasion will include a series of measures for documentation of the economy, which go beyond the tax survey recently undertaken by the government, alongwith stronger enforcement measures. It is extremely important, however, that before such steps are undertaken, there is a complete restructuring of the CBR, including a purge of corrupt and inefficient officials, simplification of laws, re-engineering of business processes and streamlining of the appeals process.

Beyond curbing tax evasion and eliminating tax expenditures, there are a number of areas of taxation that have hitherto been left unexplored and underdeveloped, but which have the potential not only to make Pakistan's tax system more progressive, but also to raise additional revenue. These include the agricultural income tax, the urban property tax and capital gains taxes which have the combined potential of yielding up to Rs 25 billion.

As the above elements of tax reforms get implemented, it is crucial that some of the additional revenues be passed on in the form of a reduction in the tax burden on the poor. In particular, the standard rate of General Sales Tax (GST), which has become an increasingly regressive tax, should be reduced and brought down from 15 percent to 10 percent. Also, the exemption limit for income tax purposes should be enhanced to avoid a situation whereby households with income below the poverty line are compelled to pay income tax.

Pricing Policy

As far as pricing policy is concerned, the government administers the prices of a number of key commodities and services like wheat, medicines, petroleum products, urban transport, electricity, gas, water, etc., which have a vital bearing on the cost of living of the poor. In recent months, the prices of petroleum products have risen sharply in response to rising international prices. A pro-poor pricing policy at this time would have been to reduce the tax content in the price of products like high speed diesel (HSD) and kerosene oil. Also, public utilities must pursue a policy of low tariffs for life-line supplies.

5.2 Social Safety Nets

There will continue to be large pockets of the hard-core poor who cannot benefit from more opportunities and the process of empowerment. Therefore, the development of adequate social safety nets will be a natural complement, but not a substitute for the other elements of the poverty reduction strategy.

An appraisal of social safety nets in Pakistan demonstrates the low priority that government has historically assigned to direct interventions for poverty alleviation. Most schemes have weak institutional structures. Their funding is uncertain, their targeting inefficient, and their coverage very limited. The underdevelopment of social safety nets at least partly explains the growing incidence of poverty in the country.

The government has announced that it will focus on four indirect anti-poverty interventions: the Integrated Small Public Works Programme (ISPWP), establishment of a new microfinance bank (the *Khushali* bank), the Food Support programme (FSP) and improvements in the *Zakat* system. We have evaluated these initiatives in terms of their scale, design features and implementation modalities and their likely impact on poverty.

Employment

The ISPWP, which has been allocated Rs 21 billion in 2000-01, aims to create employment and income-generating activities through community participation and local involvement in the implementation of a large number of small projects of farm-to-market roads, water supply, electrification, schools, etc.

The poverty alleviating impact of a public works programme can be maximised by, first, resorting to labour-intensive techniques of construction, second, setting the wage rate below the market level to ensure self-selection, third, targeting areas with high concentration of poverty, fourth, synchronising work with the timing of agricultural slack seasons and, fifth, ensuring proper mediation by NGOs and community groups in order to protect the rights of the poor.

Based on these considerations, the ISPWP appears to have a number of problems. First, funds for it have been diverted from other programmes and, therefore, it is not clear if the 0.5 million jobs created will be additional in nature. Second, the provincial governments are likely to have difficulties in financing this programme due to lack of resources. Third, changes in institutional arrangements to ensure local involvement, proper targeting, minimisation of leakages and increased use of labour have not yet been specified. Fourth, the wage rate proposed (at Rs 100 per day) is too high and enhances the probability of participation by already employed workers. Fifth, the programme is biased in favour of men, given the nature of activities and existing cultural practices.

The *Khushali* bank has been established to mobilize funds and to provide sustainable microfinance services to the poor, particularly women, in order to mitigate poverty and promote social welfare and economic justice through community building and social mobilisation. The bank will make both individual and group loans, with the loan size ranging from Rs 3000 to Rs 30000 at market-based interest rates (upto 20 percent). Community mobilization for group loans will be undertaken by NGOs, while special microfinance counters will be established in the branches of government-owned commercial banks.

The government's effort in microfinance follows many successful experiments worldwide, such as the Grameen Bank in Bangladesh. Elements of success include the reduction in transaction costs by group-based lending and in default by peer monitoring within a group. Such lending also eliminates the need for physical collateral and its substitution by social collateral. However, microfinance is not free from shortcomings. International evidence suggests that such financing is not well suited for the poor, who frequently require consumption and not production loans. Also, it rarely generates new jobs.

There are reasons, however, to be optimistic about the future of the *Khushali* Bank, because it starts with a number of distinct advantages. First, it is likely to obtain cheap (perhaps forced) equity from Pakistani commercial banks. Second, as per the ordinance promulgated for its establishment, it is not under any obligation to pay dividends to its shareholders. Third, it has been granted complete tax exemption on its income or profits. Fourth, it is not required to follow the normal reserve requirements or prudential regulations of the central bank. Fifth, it has already been promised a large and subsidised credit line by the Asian Development Bank. Sixth, it has developed a partnership with a large NGO, the National Rural Support Programme, which already has significant experience in preparing communities for receiving microfinance. Seventh, it has free access to branches of the nationalized banks. But despite these many advantages it is too early to say what impact the *Khushali* Bank will have on alleviating poverty in Pakistan.

Income Support

The Food Support Programme (FSP) is a new initiative. The programme has been granted Rs 2.5 billion, and is anticipated to benefit an estimated 1.2 million households, earning less than Rs 2000 per month, with each beneficiary receiving Rs 2000 per year in biannual installments. The launch of the FSP demonstrates clear recognition by the government of the need to provide basic food security to poor households following the significant increase in the price of wheat flour.

The FSP has a number of potential problems. First, if the *Bait-ul-Maal's* existing lists of beneficiaries are used for identification of the recipients of the subsidy then there is a danger of serious mistargeting, as *Bait-ul-Maal's* funds have been notoriously prone to leakage and corruption. Second, since the subsidy is in the form of cash there is no guarantee that the amount received will be used to enhance nutritional standards. Third, the coverage is very limited and even households which meet the eligibility criteria may be excluded. Fourth, although the programme indicates a preference for helping minorities and women, no special mechanisms are proposed to reach them. Fifth, in the absence of earmarking of a revenue source to finance the programme, there are concerns about the fiscal sustainability of the scheme.

Zakat is the most important cash transfer scheme in Pakistan. It is mandated by religion and is officially collected from *Sunni* Muslims. Those eligible to receive *Zakat*, the *Mustahiqeen*, include the poor (especially widows and orphans), as well as people with handicaps and disabilities. Two main types of support are provided through the scheme: a monthly *guzara* (subsistence) allowance of Rs 500 (increased from Rs 300 recently) and a rehabilitation grant of up to Rs 5000. There are currently 1.5 million *Mustahiqeen*.

Zakat performs fairly well as a social safety net. First, the subsistence allowance appears to be adequate. Second, administration costs are low, due primarily to voluntary inputs. Third, it is financially sustainable because of access to an earmarked source of revenue. But it also has a number of problems, including some doubts about its targeting efficiency and the fact that it may largely substitute for private transfers. There are serious delays in the disbursement of the allowance to beneficiaries and absence of any monitoring arrangements. The government now proposes to concentrate more on rehabilitation allowances in order to reduce, to the extent possible, the state of permanent dependence of beneficiaries.

Overall, despite the greater emphasis now on anti-poverty interventions, the above social safety nets are likely to have only a small impact on the incidence of poverty in the country. The total value of public transfers is estimated at Rs 20 billion, representing a paltry 0.6 percent of the GDP, and a maximum of about 3 million households are likely to be reached (out of 8 million poor households). The quantum of support is likely to be inadequate to take many of these households out of poverty.

Clearly, the government has to commit itself to substantially larger transfers through wider and deeper social safety nets and to simultaneously improve the institutional arrangements for targeting and benefiting the poor. While the existing interventions need to be strengthened, other mechanisms also need to be put in place. Two sections of the population beyond those already covered need special support. The first category is that of the elderly and retired low-income workers. The existing Employees Old-age Benefit Institution (EOBI) is a potentially useful institution for providing social security and the government has recently announced an increase in pensions from Rs 425 to Rs 630 per month. But EOBI's coverage is very limited and access is difficult. It currently covers fewer than 20 percent of workers in urban areas. The scheme could be improved by asking employers to pay a flat rate contribution per worker, and ensuring that this is matched by the government. In addition, the scheme should be opened up to the self-employed, as well as to employers in establishments with fewer than 10 workers.

The other category is that of households who suffer a loss of assets or life due to natural calamities or disasters. The ineffectiveness of the present government system to respond quickly and effectively to emergencies has been demonstrated by the inadequate response to the recent draught in Pakistan which, in some remote parts of the country, even affected life-line water supplies. Institutional arrangements, including the involvement of NGOs, will need to be strengthened in order to respond effectively to future calamities or disasters. In addition, the government must establish a permanent Disaster Relief Fund, to which contributions are made annually. The fund would provide support to poor families, particularly to resurrecting their economic lives in the aftermath of a disaster. Such a fund could also become the focal point for private charitable contributions.

Beyond this, the government's priority in its poverty alleviation programme should be to provide more employment opportunities by upscaling the Public Works Programme, subject to the development of adequate institutional capacity and proper implementation modalities. The present ISPWP is highly skewed towards rural areas, whereas urban poverty is also high and increasing rapidly. The additional allocations should be used for starting a *Katchi Abadis* and Slum Areas Improvement Programme, involving the provision of basic infrastructure such as roads, water supply, sewerage and sanitation. Not only will this provide employment opportunities to construction workers in urban areas, a high proportion of whom are currently unemployed, but it will also provide significant secondary benefits to the urban poor, who generally live in *Katchi Abadis* and slum areas.

6. ROLE OF DONORS

Both globally and in the context of Pakistan, donors have increasingly placed poverty reduction as one of the principal objectives governing their assistance. There have long been concerns about the impact on poverty of the typical structural adjustment and stabilization programmes implemented by the IMF in various countries. In recent years, these concerns have heightened considerably as a result of the impact that IMF conditionalities have had on poverty in countries (especially Indonesia) that were severely affected by the East Asian financial crisis. Leading intellectuals, NGOs, and civil society groups in the West have increasingly questioned the policies of the WTO, the World Bank and the IMF. These concerns have been manifested in major public demonstrations.

Consequently, there has been a process of fundamental rethinking. The IMF has replaced its conventional extended structural adjustment facility (ESAF) with a new poverty reduction and growth facility. The Asian Development Bank has recently finalized its long-term lending strategy (up to 2015), which envisages 40 per cent of future lending to member countries being directly for poverty reduction. Many of the bilateral donors and UN agencies, which have traditionally had a greater concern for social development, have further increased their focus on poverty alleviation. There is now a universal commitment to reduce global poverty by half by the year 2015.

The promotion of poverty reduction from being a residual item in the development assistance agenda to the focal point in lending operations is beginning to create a potentially new set of problems. Countries such as Pakistan, which have large concentrations of poverty, are increasingly being confronted by a multitude of donors, both multilateral and bilateral, talking primarily of poverty reduction and proposing initiatives largely in this area. This has raised the likelihood of duplication and the overlapping of efforts towards poverty alleviation. Clearly, if this process is to be handled efficiently, there will have to be much greater coordination of the role of donors and adequate recognition of the limits of institutional capacity of recipient governments, especially given the fact that, in countries like Pakistan, poverty alleviation programmes, including the establishment of social safety nets directly targeting the poor, have traditionally been accorded low priority.

Who should perform this coordination of poverty reduction initiatives? What should be the key directions and programmes of funding by donors in the area of poverty reduction? Can and should countries like Pakistan borrow internationally, even on concessional terms, to finance programmes/projects aimed primarily at poverty alleviation? These are some of the important issues and questions that arise in the context of the role of donors in the area of poverty reduction.

As far as the issue of coordination of the role of donors is concerned, this clearly has to be the responsibility of the national government. Such coordination must be undertaken within the overall framework of a national poverty reduction strategy, which clearly articulates the objectives, targets, instruments and modalities, and highlights the government's own priority initiatives. This strategy must be developed on the basis of a participatory approach that recognizes the importance of the involvement of the poor in deciding on their own priorities for support. NGOs and civil society groups can play a useful role in articulating these preferences.

Once the national poverty reduction strategy is developed, and the space for the participation of donors has been identified, then it will be possible for individual donors to carve out niches of assistance based on their own comparative advantages and preferences. The task of donor coordination in the area of poverty alleviation could possibly be performed by the Planning Commission, for which purpose a separate Poverty Alleviation Programme (PAP) wing should be created. This wing should act as the Secretariat for a PAP National Steering Committee, which should preferably be chaired by the Chief Executive (to signal the priority) and meet at least once every quarter. Both federal and provincial governments should sit on this committee, along with representatives of NGOs and civil society.

Regarding the nature of support from donors for implementation of the national poverty reduction strategy, it needs to be emphasized that, given Pakistan's current economic problems, this role has to be initially at the macro level in order to have the maximum impact. We have already highlighted that Pakistan potentially has a severe balance of payments problem, which will become virtually unsustainable after the expiry of the current period of debt relief in December 2000. Therefore, the first priority has to be given to finalizing a medium-term poverty reduction and growth facility with the IMF and other donors, which ensures enough balance of payments support (including a second round of debt relief) to create the necessary space to pursue a programme of structural reforms along with sustained efforts at poverty alleviation. This could be perhaps the greatest contribution that donors can make to ensure that poverty does not rise exponentially in Pakistan. A short-term Standby facility, of the type which has been offered by the IMF to Pakistan, will primarily focus on macroeconomic stabilisation and may even have deleterious consequences on poverty.

Beyond this, it is our view that the basic welfare role must be performed by government in the form of transfer payments to the hard-core poor, although NGOs could provide assistance in this area. Donors can assist financially and otherwise in the employment-generation and empowerment components of the poverty alleviation programme, while smaller bilateral donors can contribute to special initiatives related to the development of a database and research on poverty, and to monitoring poverty trends and the poverty impact of different programmes/projects. The microfinance component of the employment-generation strategy has already been promised large-scale financial assistance by both the World Bank and the Asian Development Bank. Other donors could provide additional resources for the Public Works Programme with investment in pro-poor services like farm-to-market roads, tertiary irrigation, etc. More importantly, it is essential that the donor commitment to the Social Action Programme be sustained at a time when the government is beginning to retreat from this area. This programme is vital for empowering the poor and increasing their capacity to get out of the poverty trap. Donors will need to exercise enough leverage to ensure that the badly needed institutional and policy reforms are implemented in this programme. Also, there will have to be greater reliance on grant assistance rather than loans (howsoever soft) for poverty alleviation programmes, as these programmes are unlikely to contribute directly to enhancement in debt repayment capacity.

In conclusion, we want to reiterate that Pakistan is perilously placed. There is the likelihood of a 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.

A NATIONAL POVERTY REDUCTION STRATEGY AND THE ROLE OF DONORS[?]

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SOCIAL POLICY AND DEVELOPMENT CENTRE
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