



Research Report No. 28

**IMPACT OF ECONOMIC
ADJUSTMENT ON SOCIAL
DEVELOPMENT IN PAKISTAN**

SOCIAL POLICY AND DEVELOPMENT CENTRE

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**Impact of Economic Adjustment
on
Social Development in Pakistan**

By

**Hafiz A. Pasha
Aisha Ghaus-Pasha
Sajjad Akhtar
Zafar H. Ismail**

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Social Policy and Development Centre

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INTRODUCTION

The performance of Pakistan in the area of social development has generally been compared unfavourably with other countries. Today, Pakistan ranks 138 out of the 174 countries covered by the Human Development Index (HDI) of the UNDP. Prospects of improvement in the low level of social development in the country have been diminished by the events that have unfolded since the nuclear blasts in May 98 and the imposition of sanctions by G-7 countries and multilateral agencies on Pakistan.

The objective of this paper is first to develop a macroeconomic scenario for Pakistan over the next five years, especially in the context of the ESAF/EFF program revived recently with the IMF, which envisages a strong process of structural adjustment alongwith debt rescheduling. We then highlight the consequences of the emerging scenario on social development, focusing especially on the impact on unemployment and poverty and on groups like women and children. The basic conclusion is that some of the actions taken by the government to counter the sanctions have, more or less, permanent negative effects on growth prospects for the economy. Coupled with this, some of the policy conditionalities in the IMF program have either direct or indirect implications on poverty in Pakistan. Consequently, over the next five years it appears that poverty could rise significantly in Pakistan.

The paper then evaluates the prospects for the Social Action Program, which is seen as central to the process of social development in Pakistan. The emerging fiscal constraints to expanding the expenditure allocations for the program are highlighted. This is followed by a review of the existing social safety nets, leading to the same conclusion of institutional and financial constraints. The paper makes a plea for a strong commitment by government, donors and civil society at large to a national poverty alleviation program and spells out the key elements of such a program.

I: MACRO-ECONOMIC SCENARIOS

The Integrated Social Policy and Macro (ISPM) Model for Pakistan developed by the Social Policy and Development Centre provides the basic framework for generating alternate scenarios of economic growth. One of the unique features of the model is that for the first time in Pakistan, it provides a planning tool wherein the social, public finance and macroeconomic dimensions of the economy have been integrated under one system. 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.

Due to its highly disaggregated character, covering all three levels of government, the model is capable of predicting outcomes in greater detail even at the level of provision of individual social services. It should be noted that such a disaggregation of the model at the provincial level, in terms of revenue and expenditures on social services (e.g., schools, hospitals, doctors, teachers, enrollments, etc) is, in fact,

necessary particularly in order to analyze the impact of IMF/WB Structural Adjustment Program on disadvantaged groups of society.

TABLE 1 NUMBER OF EQUATIONS IN ISPM MODEL			
	Behavioural Equations	Identities	Total
Macro-Economy	33	44	77
Public Finances	47	41	88
Social Development	49	51	100
Total	129	136	265

The model is based on a consistent national level data covering the period 1973-98 and is estimated by single equation regression techniques. It consists of 265 equations, of which 129 are behavioral and the rest are identities. These equations are subsumed into 22 inter-related blocks.

As the primary focus of the model is to assess the impact of various policies on social indicators, the social development module has the largest number of equations and identities.

The 22 blocks are divided among the 3 modules as follows:-

Macro Economy: production, economic infrastructure, input demand and unemployment, macroeconomic expenditure (investment, consumption, etc.), 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 fiscal effort blocks.

Social Development: human capital, public health, poverty, educated unemployment and gender inequality.

Sixty-four exogenous variables drive the model. Important ones are listed below:-

External Environment: foreign aid, external commercial borrowing, other private inflows, overseas labor migration, home remittances, world income, export prices (in \$), import prices (in \$)

Policy Variables: real effective exchange rate, interest rates, discretionary changes in taxes, cost recovery ratio in services, defence expenditure, grants, subsidies, inter-governmental fiscal relations,

federal non-tax revenues, development surcharges (gas, POL), development expenditure of autonomous bodies (WAPDA, etc), unit costs and wage rates in social services.

Although, the model is broadly Keynesian in spirit, the specification of individual blocks and equations are based on a pragmatic approach. It captures the reality and non-market clearing aspects of Pakistan's economy. Due to the large agriculture sector primarily based in the rural areas and information not readily available to farmers and, more importantly, due to prevalent government administered agriculture commodity price support programs, i.e., for wheat, rice, cotton and sugarcane, these prices do not always clear the market. Thus, the macroeconomic block is essentially supply driven. In addition the social sector indicators are also resource determined.

The model is dynamic, and rich in specification. The nature of linkages across the model varies. In some cases, the linkage is simultaneous, in which equations in a block are not only determining equations in another block, but are also determined by them. Examples include the linkages between the macro production and input block, the production and macro expenditure blocks and the fiscal revenues and expenditure blocks.

A Counter-factual versus the Sanctions Scenario

Prior to the May 1998 nuclear blasts, the economy was on track with the 'softer' ESAF/EFF program signed in October 1997. We forecast the performance of the economy if Pakistan had not exploded the nuclear devices, and economy had continued on pre-blasts/sanctions path of recovery i.e., a counter-factual situation. International sanctions imposed after the blasts implied short and long-term costs to the economy. We simulate the model to compare the costs of sanctions on the economy in relation to the counter factual situation.

How did the short-lived sanctions affect the macro environment? As a consequence of crisis management, specifically on the balance of payments front, the impact of the sanctions in terms of reduced private capital inflows (FCAs, FDI, home remittances, and foreign aid) was transmitted, more or less, immediately. Adopting dual exchange rate regime translated into a real effective devaluation. Sanctions jolted the confidence of private investors (local and foreign) resulting in lower private investment activity. A tight fiscal and monetary policy were adopted. On the fiscal front non-tax revenues fell due to fall in the profits of State Bank of Pakistan. The fall in revenues were offset by a 25 per cent hike in petrol prices and cut in annual Public Sector Development Program (PSDP). Autonomous bodies i.e., WAPDA, KESC also began to curtail their development expenditures.

The numbers in Table 2 highlight the differences between the performance of macro indicators in the pre and post blast/sanctions situation in the first year. It is apparent from the performance of macro 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

TABLE 2			
COMPOSITION OF KEY MACROECONOMIC MAGNITUDES IN THE PRE-BLASTS AND POST-BLASTS/SANCTIONS SCENARIO 1998-99			
	Pre-Blasts Scenario	Post-Blasts/ Sanctions Scenario	Difference
GDP Growth Rate	6%	3%	-3%
Rate of Inflation	6%	5%	-1%
Budget Deficit [?]	6%	6%	0
Current Account Deficit [?]	3½%	6%	2½%
? As % of GDP			

deficit in post-sanction era, are lower or worse than in the counter-factual pre-blast/sanctions position. Tight fiscal policy specifically expenditure curtailment artificially closed the budgetary gap. Predictions of lower inflation in the post-sanctions reflect onslaught of deep recessionary conditions in the economy. The growth in real GDP and manufacturing is lower by 3 and 6 per cent respectively in the post-sanctions scenario. The latter suffers notably due to drop in capacity utilization as a consequence of import compression and recessionary conditions. The current account deficit is higher by 2.5 per cent of GDP. This gap mainly reflects the lower level of remittances and absence of FCAs as a financing source of current account deficits. In the medium run this deterioration in external accounts was clearly unsustainable.

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 either facing the consequences of declaring a unilateral moratorium on its external payments or entering into a negotiated settlement with its international creditors and attempting to rescue quickly the bruised economy. In the next section we analyze the economic consequences of choosing the second option.

The IMF Program Scenario

Given the high short-run political and economic costs of unilateral moratorium on its external debt payments and the consequent tough policy actions, the Government of Pakistan concluded a debt rescheduling agreement in January 99 with the Paris Club along with the revival of October 1997 ESAF/EFF program of the IMF and World Bank.

In what respects the economic environment will be different from what was prevailing prior to the blasts? Home remittances and private external inflows (FDIs etc) will be lower in view of the loss of

confidence resulting from the exchange controls and freeze on FCAs. The revived ESAF/EFF program along with debt rescheduling will restore net foreign aid at higher level. Unification of exchange rate in FY2000 will imply a higher real effective exchange rate. The policy will be reinforced by lowering tariff rates to a maximum of 35 per cent in order to reduce anti-export bias. Substantial fiscal adjustment called for by the revived program will mean higher discretionary changes in general sales tax (due to higher tax rate and broad-basing) as compared to the 'softer' program priori to the blasts. The debt relief will be in the form of lower interest payments and repayment of principal on external debt until the year 2000-01. Domestic debt retirement will push interest rates below the pre-blasts level. The need to generate higher public savings means a tight fiscal policy enforced via lower PSDP and higher surcharges from the petroleum sector.

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 the original ESAF/EFF program? In essence, the difference between the two scenarios represents the, more or less, permanent costs to the economy of acquiring the nuclear capability which can be traded off with the perceived non-quantifiable gains in the nation's security through development of military deterrence.

	1998-99			1998-99 TO 2002-03 [Average]		
	Pre-Blasts Scenario	IMF Program	Difference	Pre-Blasts Scenario	IMF Program	Difference
GDP Growth Rate	6%	4%	-2%	6%	5%	-1%
Rate of Inflation	6%	8½%	2½%	6½%	6%	-½%
Budget Deficit	6%	4½%	-1½%	6½%	3½%	-3%
Current Account Deficit	3½%	4%	½%	3%	3%	0
Domestic Debt/GDP	46%	42½%	-3½%	49%	20%	-29%
External Debt/GDP	51%	57%	6%	52½%	64%	11½%
Total Debt/GDP	97%	99½%	2½%	101½%	85%	-17½%

We use the ISPM model to simulate the consequences of the ESAF/EFF program. The objective is to empirically document the direction and magnitude of impact on selected key macro indicators. Table 3 gives the differential impact (in percentages) between the pre-blasts scenario and the scenario following implementation of ESAF/EFF program package (including debt re-scheduling).

The economy suffers an immediate loss of growth momentum equivalent to 2 per cent of GDP. Over a five year period (or on a permanent basis) an average of 1 per cent annually of GDP growth is foregone. The large impact of the new package on inflation rate and indebtedness largely hinges on the conduct of exchange rate policy. To compensate for the loss of inflows into foreign currency accounts

and lower foreign direct investment in the short-run the revived program underscores the need for substantial re-alignment of the exchange rate in real terms. The model indicates an additional 9 per cent nominal devaluation in the first year to steer the economy out of BOP crisis. In the model larger impact on inflation is primarily transmitted through the substantial re-alignment of the exchange rate. In practice nominal devaluation of 15.4 per cent (Rs.52 from Rs.44) since the imposition of sanctions has not visibly helped exports primarily because of 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. Dual exchange rate, deflationary trends in international prices, favorable domestic food stocks, stringent monetary policy and recession in the economy appear to have suppressed temporarily the inflation costs of nominal devaluation.

In the longer run, the effects of initial adjustment in the exchange rate fade away although the annual average adjustment over the 5 year period is marginally higher (extra ½ per cent per annum) for the revived package. The initial upsurge in inflation rate subsides with 5 year average difference almost disappearing between the two situations in the long run. Initial benefits to external trade do not expand and are merely sustained. Except for debt indicators, projected five year averages indicate that the losses and gains in initial differences converge between the two experiments 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 two to three per cent of the GDP. It appears that contrary to claims by the government of the IMF package leading 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 more than 10 percentage points. Clearly, Pakistan will emerge from the grace period of external debt repayment, more vulnerable to foreign exchange crisis, unless exports, in particular, improve dramatically in the intervening period.

II: OUTLOOK FOR SOCIAL DEVELOPMENT

It has been demonstrated in the previous section that the economy of Pakistan has been impacted upon, more or less, permanently by the blasts and the imposition of sanctions. The key question is what the impact of the macro economic developments is on some key social dimensions like poverty, employment, wages, children and women?

The SPDC ISPM model, as elaborated earlier, is capable of tracing the chain of major linkages between the macro economy, public finances and social development. For example it identifies the potential impacts of exchange rate depreciation on poverty. The impacts can both be negative and positive. On the negative side, exchange rate depreciation can lead to the following: raise the costs of debt servicing leading to an increase in fiscal deficit and thereby more inflation and higher poverty; raise domestic prices of tradeables, again leading to more inflation and higher poverty; raise prices of imported capital goods, thereby discouraging private investment which leads to a decline in employment and income and therefore enhances poverty.

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 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 higher costs of debt servicing. Altogether, the overall impact of exchange rate depreciation in poverty is ambiguous.

This example demonstrates how the ISPM model can be used to simulate the impact on key variables such as poverty, unemployment rate etc.

Impact on Poverty

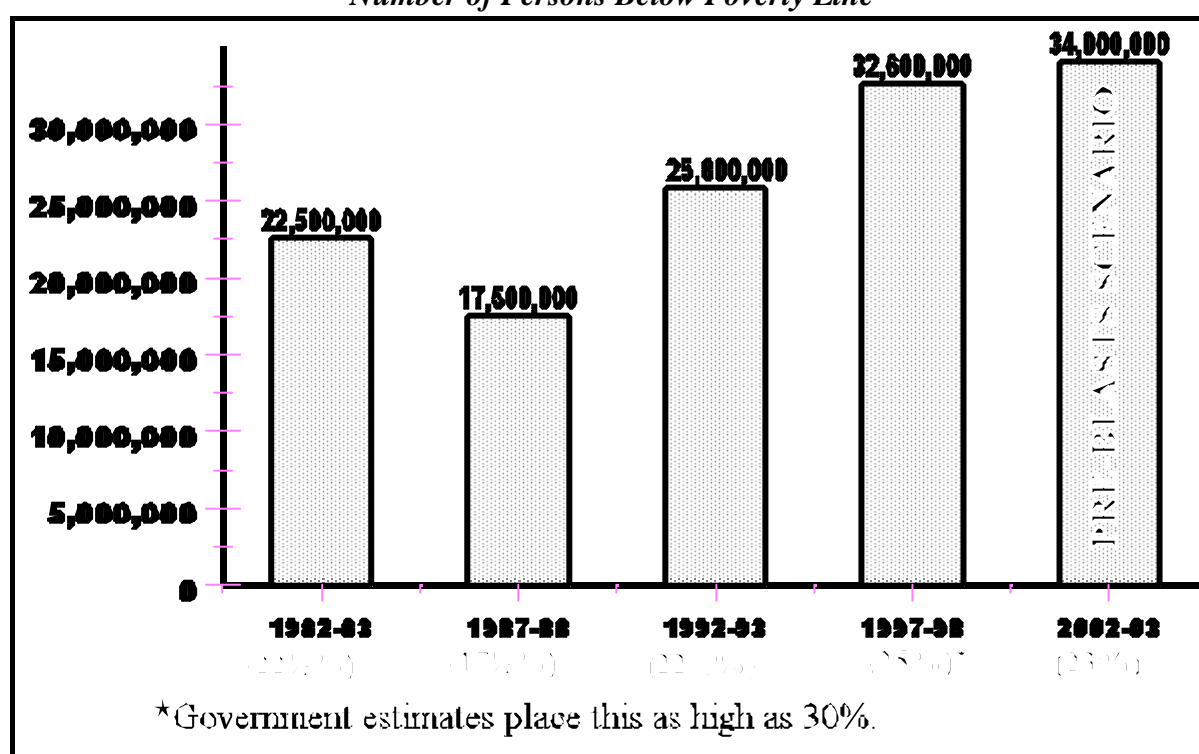
The policy framework agreed to by the government of Pakistan with the IMF contains a number of conditionalities, the implementation of which could have important consequences on poverty. Chart 1 identifies the potential contribution of each policy measure on poverty. The consequence of some policy actions are clear, such as the positive impact of higher foreign aid and program assistance plus debt rescheduling, improvement in tax administration, development of AIT, the unfavourable effects of broadening of GST, rise in power tariffs, withdrawal of consumer subsidies, cut in development expenditures and scaling down of SAP. Other policy moves such as the market-based exchange rate and tariff reforms have ambiguous consequences on poverty.

CHART 1 IMPACT OF POLICY CONDITIONALITIES IN THE IMF PROGRAM ON POVERTY	
POLICY MEASURES	IMPACT
Higher Foreign Aid and Program Assistance Plus Debt Rescheduling	Positive
Improvement in Tax Administration	Positive
Development of AIT	Positive
Move to Market-based Exchange Rate and Exchange Rate Depreciation	Ambiguous
Tariff Reforms	Ambiguous
Broadening of GST and enhancement in Rate	Negative
Rise in Power Tariffs	Negative
Withdrawal of Consumer Subsidies (wheat, etc.)	Negative
Cut in Development Expenditure	Negative
Scaling Down of SAP Expenditure Targets	Negative

Consequently, we have used the ISPM model to simulate the impact of various policy measures on key factors determining poverty in Pakistan. These include the level of real per capita income, rate of inflation in food prices, the unemployment rate and human capital endowment of labor force. Besides, the level of real per capita home remittances is also a key influencing factor. This enables quantification of the resulting impact on poverty.

Historically, the incidence of poverty in Pakistan has been declining with the exception of the 1990's (see Chart 2). Percentage of population below poverty line declined from 22½ per cent in the early 80's to 17½ per cent by 1987-88. An upturn was witnessed in the 1990's whereby 22½ per cent of the population fell below the poverty line by 1992-93. Government estimates place the incidence of poverty currently at 30 per cent of the population. We have, however, taken a more conservative estimate of 25 per cent. This implies that almost 33 million people in Pakistan live in poverty conditions. The outlook, however, was favourable if the country had continued on the path of recovery in the pre-blast scenario. The incidence of poverty by 2002-03 would have fallen down to 23 per cent, although

CHART 2
INCIDENCE OF POVERTY IN PAKISTAN
Number of Persons Below Poverty Line



this would still have meant that the number of poor people would have increased by over 2 million.

The prospects of poverty reduction now, following the implementation of the IMF program, however, have deteriorated. The real per capita income is initially projected to be about 1.5 per cent lower in the IMF program scenario in comparison to the pre-blast 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 5 per cent, due to lower growth (see table 4). The short-run impact on unemployment is small. However, in the long run, the unemployment rate will be higher by 2 percentage points. Food prices are likely to be significantly higher initially primarily because of faster devaluation of the currency. This effect will, however, diminish later. A significant decline in home remittances will further exacerbate the poverty situation (see table 4).

	Short Run (First Year) 1998-99	Long Run (Fifth Year) 2002-03
Real Per Capital Income	-1½%	-5%
Unemployment Rate	½%	2%
level of Food Prices	3%	1%
Real Per Capital Remittances	-20%	-15%
Human Capital Endowment	-1½%	-2%

Altogether, the high food prices, higher unemployment, lower per capita income and home remittances are likely to increase poverty by 1.5 per cent to 3.5 per cent of the population in the coming years compared to the pre-blast/sanctions scenario (see Chart 3). This implies that an additional 2 million people initially and 5 million people by the end of five years will slip below the poverty line in the country. The extent of contribution to higher poverty of each determining factor is given in table 5. This can provide the basis for designing the appropriate strategy for social safety nets, discussed subsequently.

**CHART 3
DIFFERENCES BETWEEN IMF PROGRAM SCENARIO
AND PRE-BLAST SCENARIO IN NUMBER OF
PERSONS BELOW POVERTY LINE**

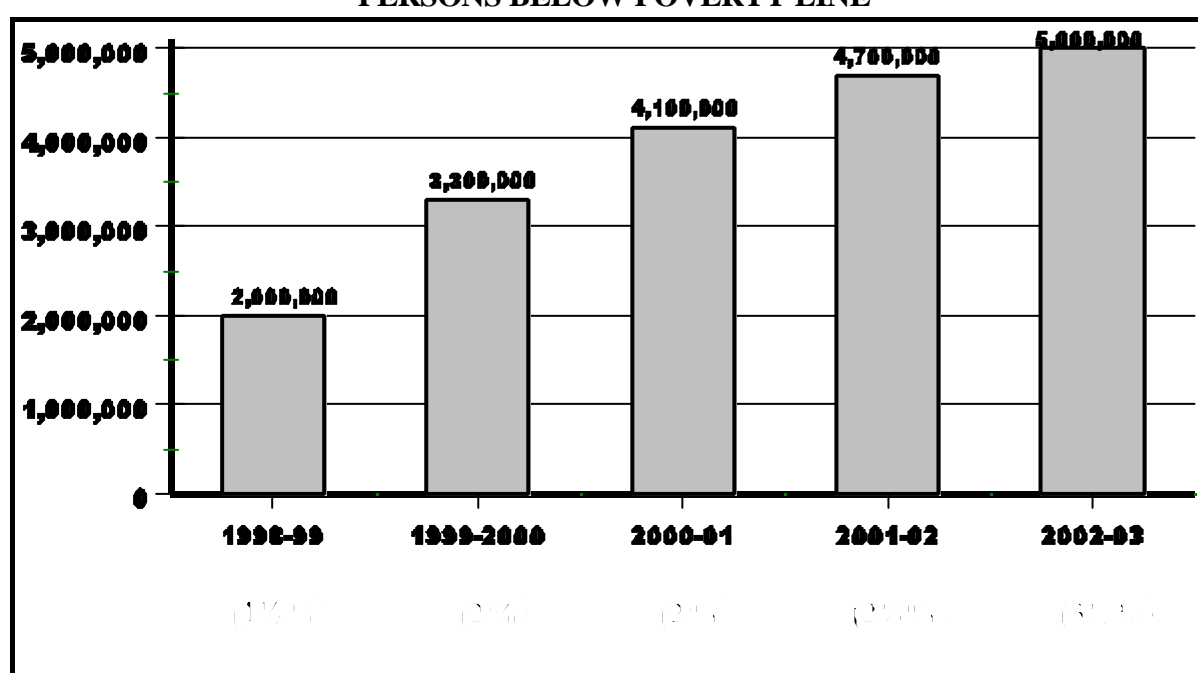


TABLE 5 WHY IS THE INCIDENCE OF POVERTY HIGHER IN THE IMF PROGRAM SCENARIO?		
	% OF CONTRIBUTION TO HIGHER POVERTY	
	Short Run (First Year)	Long Run (Fifth Year)
Lower Real Per Capita Income	30	45
Higher Food Prices	23	3
Lower Real Per Capita Remittances	23	8
Higher Unemployment Rate	13	26
Lower Human Capital Endowment	11	18
TOTAL	100	100
<i>Increase in Population below Poverty Line</i>	<i>2,000,000</i>	<i>5,000,000</i>

Impact on Labour Market

As already highlighted the IMF Program will increase the level of unemployment in the country compared to the pre-blast scenario. Initially, an additional 80,000 people will not be able to find employment (see table 6). This number will increase to 740,000 in the long run. Out of these, 200,000 will be educated (matric and above). Also, the real wage level is projected to be somewhat lower. As such, the recent economic changes are likely to have a significant bearing on the labour market in the country.

TABLE 6		
DIFFERENCES BETWEEN IMF PROGRAM SCENARIO AND PRE-BLAST SCENARIO IN INDICATORS OF LABOR MARKET		
	Short Run (First Year)	Long Run (Fifth Year)
Educated Unemployment	16,000	200,000
Matriculates	9,000	120,000
Intermediates	3,000	40,000
Graduates	3,000	30,000
Post-Graduates	1,000	10,000
Total Unemployment	80,000	74,000

Impact on Children

International experience reveals that any increase in poverty and/or decline in public social service provision is bound to adversely affect children, particularly from the poorer segments of the population. The Impact may register either through an increase in the school dropout rate or a decline in school enrollment or an increase in malnutrition. Projections from the ISPM model indicate a decline in the primary school enrollment of about 460,000 children (250,000 of which would be boys) primarily because of enhanced poverty in the country. This reduction in enrollments implies more child labour, especially in the case of boys.

Increase in child malnutrition can be a combined consequence of increased poverty, and/or higher exposure to infections. A fall in per capita income (for reasons of affordability), as well as a rise in food prices may lead to a reduction in dietary intake or substitution to inferior food items, on top of this, contraction in public sector health services can result in a decline in the quality of health care (both preventive and curative) and thereby lead to an increase in the incidence of infection.

Pakistan already has a high prevalence of child malnutrition. Almost 40 percent of children under 5 years are under weight for their age. Among the low income countries, Pakistan ranks 10 in sample of 44 countries (see Table 7). This highlights the pathetic current state of children's health in the country.

Research undertaken by SPDC on the variation in the incidence of malnutrition (as measured by the weight-to-age ratio) in a sample of 44 countries reveals the importance of the following key determinants: per capita income, extent of female literacy, and coverage of the immunisation program. The prevalence of malnutrition, controlling for other factors, is higher in countries in the sub-continent

compared to rest of Asia or Latin America, for example. Based on the projected values of the key determinants in different scenarios, it is estimated that the number of malnourished children could increase by 333,000 in the short-run and by almost 491,000 in the next few years. This is a first order impact. Therefore, special consideration will have to be given to address child malnutrition problem in the country. Appropriate safety nets will have to be designed and sincerely implemented.

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 Pakistan and to determine Pakistan's relative ranking vis-a-vis other developing countries. The index is based on the ratio of males to females in (i) life expectancy (ii) literacy rate (iii) school participation rate and (iv) labour force participation rate. A value of the index of 100 implies perfect equality. The higher the value, the greater the inequality. Table 8 presents the international ranking of gender inequality. It shows that Pakistan has the second highest value of the index, followed by Afghanistan.

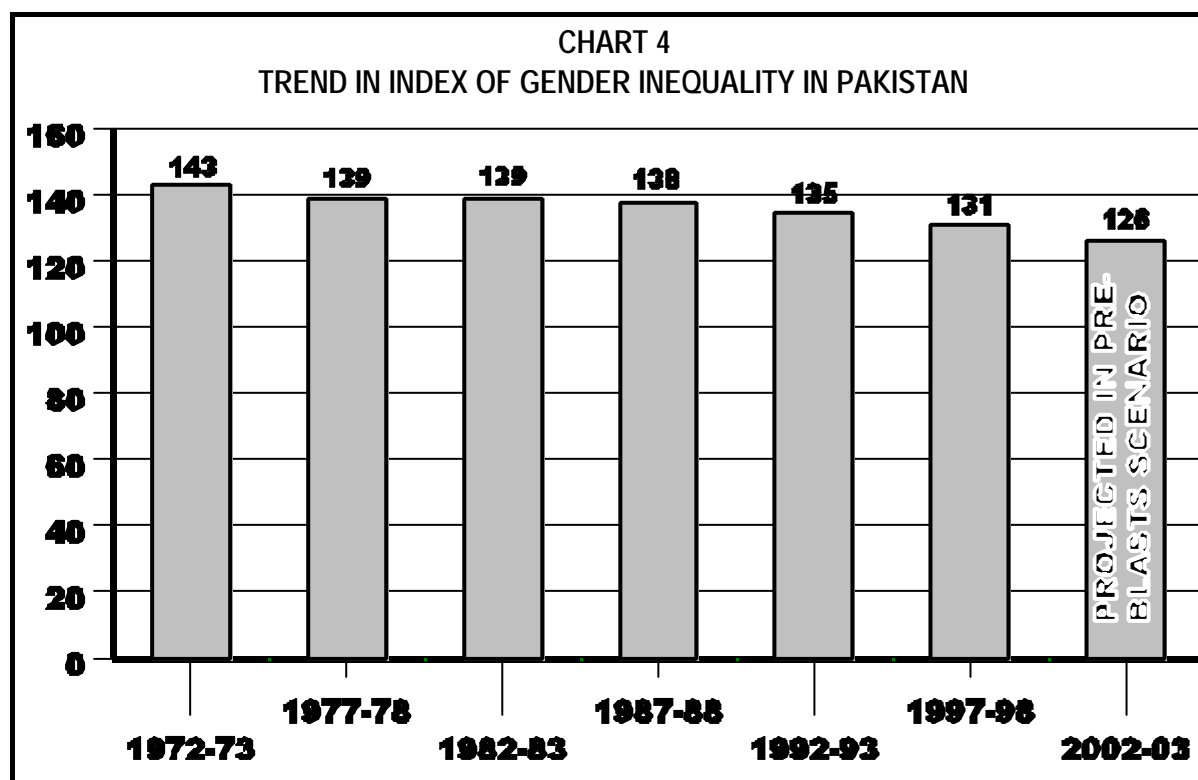
TABLE 7
PREVALENCE OF CHILD MALNUTRITION[?]

Countries (low Income Gropus)	Rank	Child Malnutriation (under -5) % age group 1989-94	Countries (low Income Gropus)	Rank	Child Malnutriation (under -5) % age group 1989-94
Nepal	1	70	Congo	23	28
Bangladesh	2	67	Tanzania	24	28
India	3	63	Ghana	25	27
Mozambique	4	47	Malawi	26	27
Ethiopia	5	47	Zambia	27	27
Burkina Faso	6	46	Haiti	28	27
Vietnam	7	45	Mali	29	25
Niger	8	44	Togo	30	24
Negeria	9	43	Uganda	31	23
Pakistan	10	40	Sierra Leone	32	23
Lao PDR	11	40	Kenya	33	23
Madagascar	12	39	Senegal	34	20
Bhutan	13	38	Honduras	35	19
Sri Lanka	14	38	Guinea	36	18
Zaire	15	35	China	37	18
Benin	16	35	Gambia, the	38	17
Central African Republic	17	32	Zimbabwe	39	16
Chad	18	31	Cameroon	40	14
Mauritania	19	30	Cote d' Ivoire	41	12
Yeman	20	30	Nicaragua	42	12
Rwanda	21	29	Mongolia	43	10
Burundi	22	29	Guyana	44	3
[?] A measured by weight-to-age ratio.					

Rank	Country	Index	Rank	Country	Index
1	Afghanistan [?]	138	12	Nigeria [?]	123
2	<u>Pakistan[?]</u>	<u>136</u>	13	Mexico	123
3	Algeria [?]	132	14	Indonesia [?]	122
4	Morocco [?]	131	15	Malaysia [?]	122
5	Sudan [?]	130	16	Sri Lanka	121
6	India	129	17	Brazil	120
7	Egypt [?]	120	18	Philippines	120
8	Bangladesh [?]	128	19	South Korea	119
9	Iran [?]	128	20	Colombia	119
10	Ethiopia	126	21	Kenya	118
11	Turkey [?]	125	22	Thailand	117

Presented in Order of Decreasing Inequality
[?]Islamic Countries

The trend in gender inequality in Pakistan is presented in Chart 4. Gender inequality appears to have declined during the decade of the 1970s. It appears to be, more or less, stagnant during the 80s due primarily to the process of Islamisation, with a decline in the 90's. This momentum would have continued into the next decade in the pre-blast scenario.



Analysis of the determinants of the level of gender inequality in Pakistan reveals the importance of the following: (i) real per capita income; (ii) age at marriage; (iii) ratio of girls' schools to boys schools; and (iv) process of Islamisation. Based on the future outlook of these determining factors, especially real per capita income and schools, it appears that the IMF program is likely to slow down the declining trend in gender inequality in Pakistan.

We are now a position to make a summary assessment of what the nuclear blasts and sanctions have costs the people of Pakistan even after the apparent bail-out by the IMF and other multilateral agencies through enhanced external assistance and debt rescheduling. In summary, over the next five years, household income will be lower by \$ 250 per annum; Pakistan's GNP will be lower by \$ 5500 million; 5,000,000 more people will fall below the poverty line; 740,000 more people will be unemployed, 200,000 of which would be educated; and, 460,000 less children will be able to attend school (see Table 9).

TABLE 9 WHAT HAVE THE NUCLEAR BLASTS AND SANCTIONS COST THE PEOPLE OF PAKISTAN	
SHORT RUN (FIRST YEAR)	LONG RUN (FIFTH YEAR)
! Lower per household income of \$ 80 per annum	! Lower per household income of \$ 250 per annum
! Lower GNP by \$ 1500 million	! lower GNP by \$ 5500 million
! 2,000,000 more people below the poverty line	! 5,000,000 more people below the poverty line
! Higher unemployment by 80,000	! Higher unemployment by 740,000
! 16,000 more educated unemployed	! 200,000 more educated unemployed
! 80,000 less children enrolled in schools	! 460,000 less children enrolled in schools

Altogether, Pakistan will pay a significant price for the acquisition of nuclear capability in the face of international sanctions. These costs must, of course, be traded off against the intangible gains to national security. The IMF package put in place is inadequate to restore fully the lost momentum of economic growth and social development.

III: POVERTY ALLEVIATION

The Social Action Program

Given the prospect of increasing poverty, we now proceed to assess the outlook for efforts at alleviation of poverty. We start with a macro economic perspective on the SAP.

Outlook for SAP Expenditure

Following the 1991 NFC award overall transfers from the federation to the provinces grew by 20 per cent per annum upto 1996-97. In the same period SAP expenditures also grew rapidly, by 22 per cent per year. However, the 1996 NFC award brought about a contraction in the transfer of resources to the provinces by about 5 per cent. Consequently, expenditure on SAP also fell by 4 per cent, as shown in table 10.

Years	Rs in Billion	As % of GDP
1991-93	22.7	1.69
1993-94	27.0	1.72
1994-95	35.5	1.89
1995-96	44.0	2.03
1996-97	51.1	2.13
1997-98 (E)	49.2	1.78

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

In 1997, the original target for SAP expenditure was 2.4 per cent of the GDP. This was scaled down to 2.1 per cent in the initial negotiations for an ESAF/EFF agreement in October, 1998. The Policy Framework Paper finally agreed to between the Government and the IMF/WB in December, 1998 has further curtailed this to Rs. 56.5 billion (excluding foreign project assistance). This represents about 1.8 per cent of the GDP for 1998-99. Even this appears now to be ambitious. The likely expenditure on SAP in 1998-99 is about 1.7 per cent of GDP, including that on donor assisted projects.

This curtailment in expenditures (both development and recurring) is likely to further deteriorate the quality of basic services provision. Already there are signs of break-down in the field. To illustrate we present a few examples reported by UNICEF field offices:

“At the National Institute of Child Health in Islamabad, it is not unknown for an unsterilised syringe to be used to infect as many as five different patients. This lack of basic medical resources has been contributed to by a curtailment of their budget”

“The Tehsil Hospital Dargai has such a shortage of syringes that vaccinators have asked clients to buy their own from the market. Mothers unable to afford a syringe for all of their children have been forced to buy one to share between

their offspring. Once used, these syringes are supposed to be incinerated. However evidence suggests that they are re-used by the vaccinators for other patients at this facility and elsewhere. Indeed, UNICEF reports reveal that in all districts of NWFP there is a non availability of syringes for immunization; during 1998 syringes were not available for most of the time.”

“In District Bannu, in three out of six centres visited the thermometer supplied in the cold chain equipment was out of order. There is no system of replacement for these essential supply items, so the crucial cold chain status remains unmonitored.”

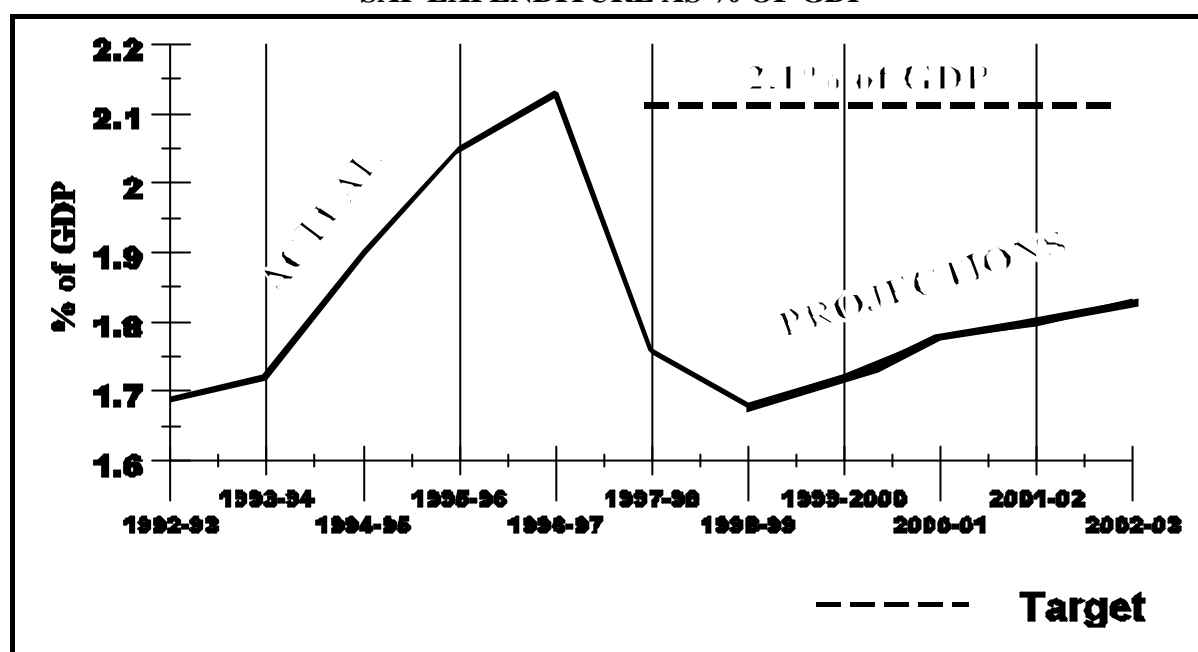
“Local government has been allocated Rs 50 million for water and sanitation program in 34 districts in Punjab. The funds for the current fiscal year were released only in late February and their tender for supplies was completed in the middle of March. The whole implementation process was delayed because of the late release of funds after almost 8 months in the financial year.”

The future path of SAP expenditures, shown in table 11, revealed by the ISPM Model indicates some improvement but up to the end of Ninth Five Year Plan, 2002-03, the expenditures on SAP will remain below 1.9 per cent of the GDP.

Years	Rs in Billion	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

This is substantially lesser than the target, which has been scaled down to 2.1 per cent of GDP, (see Chart 5). A closer examination of the composition of expenditures indicates that the expenditure on salary alone has averaged about 70 per cent of total SAP expenditure. This is equivalent to about 1.4 per cent of GDP. Salaries are expected to rise substantially in the next budget. The last adjustment in public sector salaries was in 1994. Even if government were to adjust pay partially, there is a likelihood that this would consume the differential between the salary component and total SAP expenditure thereby leaving little space for non-salary and development expenditure.

CHART 5
SAP EXPENDITURE AS % OF GDP



Therefore, financial sustainability and effectiveness of SAP is emerging as a fundamental issue. This implies that government and donors have to think seriously about restructuring and reforming SAP.

Reform Strategy

The Objectives of the reform strategy should be to improve performance and maximise the impacts within the resources available to government. This, therefore, suggests that the elements of the strategy should:

- ! identify core social services which will remain the responsibility of government and which will be protected from any expenditure cutbacks,
- ! implement institutional reforms which will increase cost effectiveness and impact,
- ! use innovative approaches which ensure sustainability,
- ! increase the direct participation and involvement of NGOs, private sector and beneficiaries, and
- ! ensure that independent monitoring and evaluation systems are installed and used effectively.

Core Program

Given that expenditure targets for SAP are unlikely to be met in view of the constrained fiscal position of the provincial governments, the basic question is what part of the SAP must be protected against any expenditure cutbacks. That is, *What are the critical minimum needs of the children, women and the poor of Pakistan that **must** be addressed by public services?* Therefore, a sort of **zero-based budgeting** for social and human welfare development in defining what should be immutable in national

budgeting must first be undertaken. In defining what should be immutable in national budget, a human rights perspective is perhaps the best starting point - using various international conventions/agreements not only as guidelines, but to define the obligations of states. For example, in Article 28 of the Convention of the Rights of the Child, States are committed to making primary education compulsory and available free to all, and in Article 24, must ensure the provision of health care to all children, and combat disease and malnutrition.

Zero-based social budgeting requires first the definition of how to meet the basic needs and rights, then identifying necessary programs and projects to address those needs and rights and finally cost the minimum level at which these must operate. The resources for a core social package fall into two categories, namely; maintenance and achieving rights, in other words delivering a basic level of service and expanding access to those outside the net. It must be clearly recognized that a social budget which has no element to expand coverage, or enhance true benefits, denies rights as spelled out in International Conventions.

While a number of important building blocks of a core social package are included in the SAP, such as, EPI, parts of primary education, primary health care especially for children and women, they are not optimally designed and implemented, nor are they adequately funded. Other building blocks like child nutrition and aspects of women health are missing, or at best, are highly inadequate.

In the development of a core programme for delivering social services by the government, there can be no dispute that the health of a nation's people must be a matter of concern to any government. Within this sector, the health of children and women must have priority as they are the bedrock on which future generations will rest. Any core programme in health must include a minimum package which ensures that their health is safeguarded. Such a programme could include the immunisation of children, which would prevent them from falling ill to a number of diseases : tetanus, measles, poliomyelitis, diphtheria, pertussis and tuberculosis. The core programme for ensuring children's health should include a component of curative care for the most commonly occurring complaints: respiratory infections and diarrhoeal diseases. Another generally accepted truism is : if mother's are unhealthy or are malnourished, they are unable to give birth to healthy babies or nurture them subsequently. A core programme in health must include the welfare of mothers as a core package. Pre-natal care ensures that during pregnancy, both the mother and child are well and that healthy babies are delivered. For this, the Prime Minister's Lady Health Workers Programme should be expanded substantially and within the medium-term (say by 2004 AD) the full complement of the planned 100,000 Lady Health Workers should be deployed. These ladies could also be used to supplement the activities of the health outlets for family planning and as a consequence of their training in midwifery would ensure that all births are attended by trained people. This should result in a substantial reduction of maternal mortality during child-birth. The core programme should also include the provision of tetanus/toxoid immunisation for all pregnant mothers and emergency obstetric care to mothers who need such services and are referred (by the lady health workers or the basic health units) to hospitals/clinics equipped to handle such cases.

The core health programme should thus consist of the following components:

CHILDREN'S HEALTH

Immunization

Acute Respiratory Infections / Control of Diarrhoeal Disease

WOMEN'S HEALTH

Tetanus immunization

Emergency Obstetrics Care Services at Tehsil (Rural Health Centres)

Universal coverage of Primary Health Care (100,000 Lady Health Workers)

Reproductive health & family planning

Availability of the right type of food and in sufficient quantities during pregnancy ensures that the pregnancy and the foetus are healthy, and thereafter ensures that the infant and the growing child remain healthy. A programme to ensure adequate nutrition should be part of a core health and nutrition package of services. The nutrition package should ensure that pregnant women are treated adequately against iron and vitamin A deficiencies and that children are protected against the effects of iodine deficiencies. Knowledge about the effects of malnutrition are not generally known to a large mass of the population in Pakistan. Thus an awareness and education campaign should be a focal point of the programme. The components of the nutrition part of an integrated cor health programme should be:

Breasfeeding promotion (incl. Baby Friendly Hospital Initiative)

Universal Salt Iodisation / Iodine Deficiency Disorders

Iron Deficiency Anaemia

Vitamin A Deficiency

Knowledge creation strategy / communication component

Monitoring strategy

(NB Nutrition a factor of both infections and nutritional intake)

The link between education and development has been established indisputably. As stated earlier the right of a child to primary education is universally accepted. Additionally, Pakistan has redefined basic education as the first eight years of schooling and has included this as part of phase II of the Social Action Programme. This expansion of the definition of basic education has also been agreed to by the international aid community. Therefore, the provision of this service as a component of a core package of social services cannot be questioned. While designing the core package for delivery of elementary education the responsibility for parental and community involvement should not be lost sight of. There is, therefore, a need to clearly define the role of each stakeholder. The basic objectives of the programme should be to achieve an enrollment of about 80 percent of children aged 5 to 7 years in class 1 of the formal segment of the education sector by the end of the Ninth Five Year Plan period, 2003. For the elementary schooling, the target should be to enroll, in each class, at least 70 percent

of girls and 85 percent of boys in the relevant age groups. The core programme should also ensure that improvements in quality should be a focal point of service delivery. This can be achieved by the adequate provision of infrastructure (through repair, maintenance, upgrading and the active participation of the beneficiaries), the availability of adequate number of trained teachers and the availability of school/class-room supplies, such as textbooks, teaching materials and students materials. The core programme must also include a communication component to mobilise communities for their active involvement. The package would thus include the following:

Net Enrollment in Formal Primary Education:

Target children aged 5 - 12 years, incrementally via 5 - 7 year olds

80% of children aged 5 - 7 years in formal education by 2003

Cost/child graduating from primary school

Infrastructure (repairs, upgrading, community involvement)

Teachers (additional, training)

Supplies (textbooks, teaching material, students materials)

Communication / community mobilisation

Gender focus -> 70% of girls and 85% of boys enrolled

Water is considered to be a free good. Traditionally, the provisioning of water has been considered to be the responsibility of government. Existing design standards adopted by the provincial Public Health Engineering Departments cost more than communities can afford. Moreover, the non-involvement of communities the standards of construction are poor. The need to redress this situation coupled to a resource constraint has resulted in the government adopting a Uniform Policy for the rural areas which embodies the principle of cost sharing between communities and the government and after the development of the scheme, the total involvement of the community in operating and maintaining the schemes. Based on a modified set of standards which takes into account the local conditions and depth of the aquifer, UNICEF has developed a set of alternative standards which are substantially cheaper, on the average of Rs. 537 per capita for Pakistan as a whole. This is based largely on a modified version of an Afridev hand-pump. Using this technology, UICEF estimates that the cost of a core programme for ensuring 100% coverage to the rural population (the SAP target group) would be about Rs. 19.7 billion. The resource crunch faced by governments in Pakistan is expected to continue. Based on the historical profile of expenditure 100 per cent coverage is expected to be achieved by the year 2010. Table 12 shows the province-wise cost and the sharing of these costs between the beneficiaries and the governments.

TABLE12 CORE WATER PROGRAMME COSTS				
	Additional Population (Million)	Per Capita Cost (Rs)	Programme Cost (Rs Million)	Government Financing (Rs Million)
Punjab	12,328	400	4,931	3,082
Sindh	7,035	320	2,251	1,407
NWFP + FATA	13,332	700	9,332	5,333
Balochistan	4,023	800	3,219	2,012
<i>Pakistan</i>	<i>36,719</i>	<i>537</i>	<i>19,734</i>	<i>11,834</i>
Source: Unicef Estimates				

For sanitation, the traditional (the engineers') solution in the rural areas has been the provision of drains. To most public health practitioners this is not part of a core strategy. The safe disposal of human excreta has a considerably higher strategy. Because of its very nature, the building of this facility should lie in the private domain. The government's involvement should be restricted to hygiene education and providing the technical assistance needed to design and construct the facility and in extreme cases of hardship provide some subsidy. Based on its decades long involvement in the sector in Pakistan and the future availability of resources with governments, UNICEF estimates that the provision of a latrine to all rural households by the year 2010 would cost about Rs. 31.5 billion of which government share would be only about Rs. 6.2 billion (see table 13).

TABLE13 CORE SANITATION PROGRAMME COSTS				
	Additional Population (Million)	Per Capita Cost (Rs)	Programme Cost (Rs Million)	Government Financing (Rs Million)
Punjab	41,262	1300	20,631	4,126
Sindh	7,189	1400	3,954	719
NWFP + FATA	9,981	1200	4,990	998
Balochistan	3,524	1200	1,938	352
<i>Pakistan</i>	<i>61,955</i>	<i>1315</i>	<i>31,513</i>	<i>6,196</i>
Source : UNICEF Estimates				

Social Safety Nets

We turn now to social safety nets, both public and private, which can be relied on to provide succour to the poor and indigent.

A study of the public safety nets (SPDC 1999) shows that total expenditure on mitigating poverty through the nine public safety nets is of the order of Rs. 24 billion, or 0.8 per cent of the GDP (see table 14). These public safety nets reach out to only about 1.9 million beneficiaries (1,500,000 through Zakat, 250,000 through the Baitul Maal and 150,000 through EOBI) against an estimated 33 million poor people in Pakistan. Moreover, the targeting efficiency is low in most of these transfers. The wheat subsidy is by and large expropriated by middle-men-o-millowners in the atta production/marketing cycle and the power subsidy is not directed solely for the benefit of the small consumer. Because of demonstrated corruption in the Baitul Maal, the contributions from this source is being cut back. Owing to increasing displacement of labour in the private sector resulting from a slow down in economic activity contributions by EOBI are also being scaled down. The recent judgement by the Supreme Court that involuntary deductions of Zakat from monetary assets from only a segment of the population is inequitable will result in minimal contributions to the safety net pool in the future.

TABLE 14	
SOCIAL SAFETY NETS IN PAKISTAN	
	Income Value of Transfer
<u>CASH TRANSFERS</u>	<u>4500</u>
Zakat	4000
Ushar	N.A.
Baitul Maal	500
<u>CONSUMER SUBSIDY</u>	<u>13200</u>
Wheat Subsidy	5000
Power Subsidy	8200
<u>SOCIAL SECURITY</u>	<u>1000</u>
Employees Old Age Benefits Institution (EOBI)	1000
<u>MICROCREDIT PROGRAMS</u>	<u>5000</u>
NRSP Program	1000
New Self-Employment Scheme	4000
<u>HOUSING FINANCE</u>	<u>300</u>
Housing Finance	300
TOTAL	24000 <i>(0.8% of GDP)</i>
<i>Source: Social Policy and Development Centre, Social Development in Pakistan: Annual Review 1999; forthcoming.</i>	

Another study (Zaman 1999) shows that the size of private philanthropy in Pakistan is substantially larger. The study estimates that the people contributed about Rs. 59 billion, almost 2 per cent of GDP, and volunteered 1.3 billion person-hours of time to voluntary philanthropic activities. However, bulk of both the money (90 per cent) and time (85 per cent) is directed to religious organisations and used largely (40 per cent) for the construction of mosques. The remainder, which is small, is directed to welfare groups, such as the Edhi Foundation, the Ansar Burney Welfare Trust, etc., with very little targeted for education and health and direct cash transfers to the poor.

Overall, the analysis of existing safety nets suggests that the Government is ill-equipped, both institutionally and financially, to handle the emerging social problems.

Poverty Alleviation Strategy

What needs to be done to face the future challenge of rising poverty has to be radical, as mere tinkering with the existing safety nets will not have a significant impact. The ESAF/EFF program essentially addresses the problem of social safety nets as an adjunct to the primary emphasis on macroeconomic stabilisation. The Policy Framework Paper governing the recent IMF/WB ESAF/EFF program recognises that poverty may increase in the short run as a result of the process of structural adjustment, but provides no new major initiatives to alleviate poverty. ***We believe that a strong commitment is required of the government, civil society at large and donors to quickly launch a nationwide program against poverty in Pakistan.***

The strategy proposed for addressing the poverty issue consists, first, of a major public works program (PWP). This would be restricted to labor-intensive investments in quick gestation projects such as farm-to-market roads, desilting of irrigation channels at the tail-end and urban infrastructure for improving the quality of life in the squatter settlements (*katchi abadis*). The size of such a program could be about 1 per cent of the GDP (or Rs. 30 billion). For best results and greater cost effectiveness this should be implemented through local government (district councils, municipalities) with the assistance of Water User Associations, NGOs, etc. This would help in mitigating poverty for an estimated 1.3 million persons. The macroeconomic consequences of such a program are shown in table 15.

Given the prospect of a severe cut back in non-salary and development expenditure in the SAP, the second element of the strategy focuses on protecting these expenditures at a certain minimum level. As such, government and donors may create a special fund for allocating an extra Rs 5 billion annually for this purpose.

A third component of the strategy is the allocation of another Rs. 5 billion by the government to protect the level of contributions to the Zakat fund at the current level and as a matching contribution to the EOBI. The former would offset the impact of the recent Supreme Court decision regarding involuntary at-source deductions from financial assets. The latter would promote savings. Coupled to this latter, the government should expand the coverage of the EOBI to include workers in smaller establishments and self-employed persons also, as the bulk

TABLE 15
MACROECONOMIC CONSEQUENCES
OF A PUBLIC WORKS PROGRAM IN 1999-2000

	IMPACT [?] OF PWP
<u>Development Expenditure^{??}</u>	<u>1%</u>
GDP Growth Rate	1%
Unemployment Rate	-2%
Rate of Inflation	1½%
Budget Deficit ^{??}	1%
Current Account Deficit ^{??}	0%
<u>Incidence of Poverty</u>	-1%
<u>Reduction in Number of Persons below Poverty Line</u>	<u>1,338,000</u>
[?] In relation to the IMF Program Scenario ^{??} As % of GDP	

of these are either daily wage-earners or hawkers, peddlers, small shop-keepers or transporters. These form a substantial part of the vulnerable group.

A fourth element of the proposed strategy is a safeguard against the expected rise in atta prices. These could rise as a consequence of a move towards market based exchange rate in early 1999-2000. Unless government preserves stability in atta prices, there is a likelihood that Indonesia-like food riots could be seen in Pakistan. Therefore, the withdrawal of the wheat subsidy proposed in the IMF/WB program should be deferred till a successful transition has been made in the exchange regime. Meanwhile, government must continue to subsidise the *imports* of wheat. These are currently being imported at the official, and lower exchange rate. Given the prospect of a significant shortfall in domestic wheat production, this year, the subsidy bill could exceed Rs. 5 billion.

Yet another element in the proposed poverty alleviation strategy is the efficient use of surplus liquidity that is currently available in the banking sector. Domestic debt retirement by government will increase dramatically the amount of credit available for the private sector. Consequently, interest rates could fall significantly. It is suggested that micro credit for employment and income generation could be increased from about Rs 3 billion now to about Rs. 10 billion. However, the Habib-Bank-NRSP micro credit scheme should be used as a model. This has substantial advantages over the self-employment scheme of the commercial banks. It is better targeted, self-monitored, less prone to administrative and political interference and has a high rate of recovery. The emphasis on micro credit also includes a recommendation for the activation of the Pakistan Poverty Alleviation Fund which has been dragging its feet for over a couple of years now.

At the end, it needs to be stated that overemphasis on reduction in fiscal deficit in the ESAF/EFF program carries it with the danger of stifling the prospects of revival of Pakistan's economy and a return to a high growth path. This will exacerbate the problems of unemployment and poverty and retard the process of social development. Therefore, while the proposed poverty alleviation program can partly be financed by additional resource mobilisation and by reducing public expenditure (especially by deferring implementation of 'mega projects) the rest will have to come through an increase in the targeted size of the fiscal deficit (say, by about 0.5 per cent of the GDP). Such an increase can perhaps be justified if it is devoted exclusively to strengthening and expanding social safety nets in Pakistan at this critical time in the nations' history.

**IMPACT OF
ECONOMIC ADJUSTMENT ON
SOCIAL DEVELOPMENT IN PAKISTAN**

By

Hafiz A. Pasha
Aisha Ghaus-Pasha
Sajjad Akhtar
Zafar Ismail

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