

PAKISTAN DEVELOPMENT FORUM (PDF)

25-27 April 2007

*The Demographic Dividend –
Unleashing the Human Capital*

BACKGROUND BRIEFS

Government of Pakistan

**Economic Affairs Division (EAD)
Ministry of Economic Affairs and Statistics
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Pakistan Development Forum 2007: An Overview

The Pakistan Development Forum (PDF) provides an opportunity for the Government of Pakistan to share its development strategy – achievements, initiatives, priorities, challenges, future plans – in a holistic manner with the country’s development partners. The understanding gained by donors at the PDF can help them more effectively plan their country assistance strategies. The PDF also allows donors to express their concerns and priorities to the Government. First held in 2001, the PDF is the successor to the Aid-to-Pakistan Consortium.

Six national level PDFs have been held between 2001 and 2006, steered by the Government of Pakistan. The 2001 PDF took place soon after a new government took office in Pakistan, and after the country signed up to the Millennium Development Goals. It also coincided with a massive reform drive in Pakistan geared towards promoting growth, development and reducing poverty. The Government used the 2001 PDF to explain its plans for the country to donors, and to ally their concerns about the transition of 1999. Subsequent PDFs have focused on the reform program, as well as on key national planning documents like the 2003 Poverty Reduction Strategy Paper (PRSP) and the 2005 Medium-Term Development Framework (MTDF). The last PDF in 2006 focused on measures being taken to promote the private sector as a driver of economic growth.

The theme of the 2007 PDF, being held from 25-27 April is **‘The Demographic Dividend – Unleashing the Human Capital’**. The concept of ‘demographic dividend’ is increasingly being used in development circles. It refers to the potential for growth and poverty reduction offered by changing age distribution in a population: specifically, as countries shift from high to low birth rates, the proportion of working age people increases and that of young dependents decreases. This creates scope for economic growth by improving labour supply, increasing savings, and allowing development of human capital. Pakistan is going through such a demographic change at the moment, creating considerable potential for a ‘demographic dividend’. However this does not come automatically: to realize it requires planning and suitable policies.

The 2007 PDF will discuss how Pakistan can take advantage of its reduced population growth rate to unleash its human capital and increase growth. The Government will share its plans for this with development partners, and seek their input on how to maximize the demographic dividend.

The **Inaugural Session** of the PDF will be held on the evening of 25 April. It will feature addresses by leading representatives of Pakistan’s major development partners: the Asian Development Bank, World Bank and Islamic Development Bank. The session will also be addressed by Dr Salman Shah, Advisor to the Prime Minister on Finance, Economic Affairs, Revenue and Statistics. The Chief Guest will be the Prime Minister of Pakistan, Mr Shaukat Aziz.

The substantive sessions of the 2007 PDF will be held over two days, 26-27 April. **Session I ‘PRSP and the Demographic Dividend’** will be used by the Government to share the outline of the Poverty Reduction Strategy Paper II with development partners. This lays out

plans, focus and policies for poverty reduction over the next three years, including strategies for realizing the demographic dividend.

Session II ‘Domestic Commerce – Key to Propelling Growth and Job Creation’ will examine Government policies and initiatives to promote commercial activity within Pakistan – something that can make a significant contribution to the demographic dividend. It will be chaired by the Federal Minister for Commerce Mr Humayun Akhtar, and panelists include Dr Nadeem-ul-Haque, Director PIDE. This will be followed by parallel sessions looking at two crucial aspects of economic growth: **Session III (a) ‘Rural Economy – Driver of Growth’** and **Session III (b) ‘Cities and Growth’**. Two-thirds of Pakistan’s population live in rural areas; 45% of the labour force is employed in agriculture and this accounts for 22% of GDP – all factors that make promoting the rural economy extremely important. At the same time Pakistan’s cities are expanding rapidly; 50% of the population are expected to be living in urban areas by 2030. Coping with this massive urbanization (meeting demands for jobs, infrastructure, housing, services, etc) and ensuring sustained growth is a major challenge.

The afternoon sessions continue the economic growth theme, focusing first on **Session IV ‘Financial Deepening and Development’**. A wide-ranging reform program initiated by the Government in 2000 has led to considerable strengthening of the financial sector, seen for example in increased FDI. The on-going challenge is financial deepening, i.e. financial development that includes not only expansion in the financial sector but also an improvement in institutions so that the financial system can allocate capital for more productive uses more efficiently. The PDF Session will examine ways to carry this out and thereby continue the progress in reforms and growth made to date.

Session V is titled **‘Industrial Growth: Moving up the Competitiveness Curve’**. Enhancing competitiveness and developing infrastructure are some of the measures needed to ensure industrial growth. The Government is implementing several initiatives in this regard. The PDF Session will examine implementation of the Government’s industrial strategy, and specific measures such as the establishment of Special Economic Zones and promotion of public-private partnerships.

This year the PDF features a **FATA Development Forum with Plenary and Roundtable Sessions**, looking at the particular growth and development challenges in the Federally Administered Tribal Areas (FATA) and associated border areas, and strategies to address these. FATA’s unique history and constitutional position have given the area considerable autonomy, but the practical consequences of this have been massive under-development – FATA lags far behind the rest of Pakistan – and security issues: both law and order problems and militancy. The attacks of 9/11 and events since then have catapulted FATA into the international spotlight and contributed to huge momentum for change. The Government’s strategy for FATA focuses on development and democratization, and is articulated in the FATA Sustainable Development Plan.

Session VI (a) National Trade Corridor and **VI (b) Water, Power and Prosperity** will examine plans to develop Pakistan’s infrastructure, in particular transport links, the water and power sectors. The Government sees these as essential for sustained economic growth

and is implementing a wide-ranging program to construct national highways, large storage dams, trans-national gas pipelines and other necessary infrastructure.

Session VII ‘Evaluating Aid Effectiveness in Pakistan’ will be chaired by the Minister of State for Economic Affairs Ms Hina Rabbani Khar. The session will examine operationalization of the Paris Declaration, and will be an opportunity for Government and development partners to take stock of where they stand on their respective commitments.

Dr Salman Shah, Advisor to the Prime Minister on Financial Affairs, will close the conference with an assessment of ‘Where do we go from here?’

Session I: PRSP and Development – Background Brief¹

In 2001 the Government launched the Interim Poverty Reduction Strategy Paper. This was followed in 2003 by the (Full) PRSP. The five-year implementation period for PRSP-I ended in June 2006. While much progress has been made in reducing poverty and improving human development indicators in Pakistan during this period, much work remains to be done. The Government is currently in the process of finalizing PRSP-II to be implemented up to 2009. PRSP-II takes the reforms and approach outlined in PRSP-I to the next level, focusing in particular on second-generation reforms and the development of human capital and job creation to take advantage of the ‘demographic dividend’. This Background Brief outlines the main features of PRSP-I and progress on its implementation; inputs into PRSP-II preparation and the main pillars of PRSP-II.

1. Poverty Reduction Strategy Paper I – ‘Accelerating Economic Growth and Reducing Poverty’

The Poverty Reduction Strategy Paper (PRSP) approach was initiated by the International Monetary Fund (IMF) and World Bank in 1999, and is now well-established. PRSPs outline the macro-economic, structural and social policies and programs that a country will pursue over several years to promote broad-based growth and reduce poverty, along with external financing needs and associated sources of funding. PRSPs provide the framework linking national policies and programs, donor interventions and the development outcomes needed to achieve the MDGs by 2015 – of which Goal 1 is to halve the proportion of the population living below the poverty line.

Core principles underlying the PRSP approach are that poverty reduction strategies should be: country-owned (with widespread stakeholder participation); comprehensive; take a long-term perspective to poverty reduction; results-oriented – identifying key objectives and sub-objectives, and providing explicit links between objectives sought and policy interventions; partnership-oriented – providing for coordination between development partners, civil society and government; and they should identify meaningful targets and indicators to monitor progress.

The Government of Pakistan produced an Interim PRSP in 2001, followed by a Draft-PRSP and culminating in the refined (Full) PRSP, produced in December 2003. Titled ‘Accelerating Economic Growth and Reducing Poverty: The Road Ahead’, the strategy comprised four main pillars:

1. Accelerating high and broad-based economic growth, focusing in particular on the rural economy, while maintaining macro-economic stability;
2. Improving governance and consolidating devolution, both as a means of delivering better development results and ensuring social and economic justice;

¹ **Disclaimer:** This Background Brief has been prepared by Dr Iffat Idris for Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government’s policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

3. Investing in human capital with a renewed emphasis on effective delivery of basic social services;
4. Bringing the poor and vulnerable and backward regions into the mainstream of development, and to make marked progress in reducing existing inequalities.

As compared to the I-PRSP the full PRSP stressed the need to remove gender inequalities and to ensure environmental sustainability. It also explicitly focused on employment generation.

The PRSP was based on recognition that the key to reducing poverty is economic growth and job creation. But it also acknowledged and addressed the need to improve development indicators – in turn requiring fundamental governance reforms to remove underlying constraints to effective service delivery – and the need to reduce inequalities. The four pillars were strongly inter-linked: economic growth provides the fiscal space to increase investment in basic services; improving governance means investments in services are efficient and effective; improving services means improved education and health indicators, which leads to a better qualified work force to promote economic growth; targeting the poor and vulnerable means the benefits of growth and improved services are felt by all.

The tenure of the PRSP was until June 2006. The PRSP Annual Report FY 2005-6 gives details of progress made in that year, as well as since inception of the PRSP. It found that the Poverty Reduction Strategy initiated in 2001 has been successful in generating growth of nearly 7% average over the past four years. This growth is broad-based, underpinned by the Government's macroeconomic policies which have led to reduced macroeconomic imbalances and debt burden, and accelerated efforts towards privatization. Sustained high growth has led to reduced unemployment – falling from 8.3% in 2001-2 to 6.5% in 2005-6 – and, along with increased pro-poor expenditure, to a substantial reduction in poverty. Between 2001-2 and 2004-5, absolute poverty levels fell from 34.46% to 23.9%.²

PRSP (poverty alleviation) expenditure rose from less than 4% GDP in FY2002, to 5.63% in 2005-6 - well above the 4.5% GDP minimum expenditure on poverty alleviation called for in the 2005 Fiscal Responsibility and Debt Limitation Act. Spending on health and education sectors increased substantially, contributing to improved development indicators. For example, net primary enrolment rates, adult literacy levels, child immunization all increased, while infant and child mortality fell.

PRSP-I has succeeded in achieving at least some of its objectives, but much remains to be done. While overall poverty levels fell, pillar four targeting the poor and vulnerable and reducing inequality was not achieved. Rural poverty fell but is still almost double urban poverty, and income inequality marginally increased during the PRSP period. Gender, inter-provincial and inter-district gaps persist. Moreover, if current trends continue, Pakistan will not achieve several of its MDG targets by 2015.

The experience of PRSP-I shows that sustained growth is vital for poverty reduction: Pakistan must take the necessary steps (including further reforms) needed to ensure this. But growth does not automatically translate into improved services, job creation and poverty

² All figures in this section taken from 'Poverty Reduction Strategy Paper: Annual Progress Report 2005-6' (PRSP Secretariat, Ministry of Finance, Government of Pakistan, November 2006).

reduction. Targeted interventions are needed to ensure the poor and vulnerable are reached, and inequalities are reduced. Overall, considerable intensified efforts must be made if Pakistan is to achieve the MDGs on time.

2. PRSP II Preparation: Sectoral Analyses

Since 2005 the Government has been engaged in preparation of PRSP-II, for the period 2006-9. As well as PRSP-I progress reports, the Government commissioned a number of sectoral analyses to provide input for PRSP-II preparation. Studies were carried out on income distribution, employment generation, gender, the impact of globalization, and environmental sustainability in relation to the PRSP.

a) *'Income Inequalities in Pakistan and a Strategy to Reduce Income Inequalities'* – This study, carried out by Dr A.R.Kemal, concluded that while PRSP-I (and the MTFD) have elements that can lead to reduction in income inequalities, most notably employment generation and the focus on improved services, they were not specifically geared towards addressing the issue. This perhaps accounts for why, while PRSP-I led to sustained growth over a multi-year period, it also saw a marginal increase in income inequality. The study recommended a number of measures for inclusion in PRSP-II to specifically tackle income inequality:

- Facilitating asset creation for the relatively less well-off, e.g. distribution of agricultural land, support to purchase livestock, distribution of plots, regularization of *katchi abadis*, investment in human capital (esp. education), access to credit.
- Promoting job creation, particularly in the labour-intensive agriculture sector and within that in the livestock sub-sector; also in industries (esp. textiles, agricultural processing, leather, light engineering), construction, and service sectors, and promotion of SMEs. Skills development is also needed.
- Giving poor people access to employment abroad, thereby improving the distributional effects of external remittances.
- Implementing pro-poor tax and expenditure policies, e.g. greater investment in services, a tax structure that taxes income directly rather than indirect taxes on goods and services used by the poor.
- Promotion of social safety nets.
- Improving governance, esp. through civil service reform, devolution and access to justice.

b) *'Employment Generation Strategy for PRSP-II'* – This study recommended that employment generation be made the fundamental objective of PRSP II, leading to economic growth and poverty reduction. The study found considerable potential in both rural and urban areas, among all education levels, for men and women across Pakistan to create productive jobs. The greatest potential for job creation is in agriculture and specifically in dairy production – this could yield 4.6 million jobs. [This option should also be pursued because poverty among rural, non-farming populations is very high.] A further 2.3 million jobs could be created in the transport sector, and 1 million each in tourism and overseas employment. In total, the study identified a potential 11.27 million jobs to be generated in PRSP II. Significantly, the study asserted that much of this employment generation, particularly in livestock and transport, will not require a lot of public sector expenditure – just suitable policies and incentives for private sector investment.

c) *'Globalization and its Impact on Poverty in Pakistan'* – This study by Dr Sohail Malik looked at the steps needed for Pakistan to meet the challenges of globalization and benefit from this, at the same time as ensuring protection of and dividends for the poor. Globalization requires open trade and investment policies so as to ensure competitiveness. Good governance and a sound investment climate are some of the pre-conditions necessary for this. But the study stressed that these policies alone will not translate into poverty reduction. If the poor are to benefit they need support to improve their skills and human capital. This in turn requires specific interventions by the Government. The study identified and stressed in particular the need for effective social safety nets: by definition globalization produces winners and losers – the latter need to be catered for if the whole process is not to be undermined.

d) *'Reducing the Gender Gap/Engendering PRSP II'* – Among achievements under PRSP-I identified by the study were: gender-responsive budgeting; leadership training of women elected representatives; reinstatement of 5% women's employment in the public sector; and micro-credit facilities for women. However, the study also highlighted a number of constraints in progress: lack of coordination between different programs; limited capacity to fully utilize funding allocations; weaknesses in monitoring of PRSP indicators. It stressed the correlation between education, household well-being and public sector employment – with the latter being the catalyst for raising women's status in society. Based on this analysis the study made a number of recommendations for PRSP II: promote coordination between different PRSP interventions; build capacity to utilize resources; promote ownership of gender initiatives among government personnel; generate disaggregated district-level data; mainstream gender indicators with PRSP targets and indicators; create incentive schemes to increase girls' enrollment in schools; promote women owned assets and resources.

e) *'Environmental Sustainability Research Study for PRSP II'* – This study found that, despite the strong nexus between poverty and the environment, the I-PRSP did not tackle environmental issues at all, while PRSP-I did so in a very limited manner. Looking at progress in the PRSP period, the study found that legislative measures were impressive but on ground little had changed in the state of the environment. Two exceptions were the expansion in the coverage of clean drinking water and the increased use of clean fuels such as CNG. Among outstanding problems identified by the study were: lack of capacity at all levels of government (especially local) to implement environmental protection measures; and weak enforcement of environmental legislation. The study made a number of recommendations for PRSP II including: improved governance and integration and mainstreaming of environmental issues; efficiency in resource use and promotion of clean fuels; safe waste disposal; use of environmentally-friendly practices in agriculture and industry; and education about environmental sustainability.

PRSP II preparation has also been informed by the changing situation in Pakistan. The major change, as compared to 2001, is that the country has enjoyed high economic growth for the past few years. However, continued growth is not automatic and, as already seen in PRSP-I implementation, growth does not automatically translate into poverty reduction for all. Hence both sustaining the high levels of growth and addressing pressing issues of distribution and inequality requires careful planning.

The second related change is that the wide-ranging reform program initiated by the Government is now several years into implementation. Whereas in 2001, and even 2003, the challenge was to design reforms and plan implementation strategies, in 2007 the challenge is modification (in the light of implementation experience to date) and consolidation; also deepening of reforms, taking the process to the next level.

3. Outline of PRSP-II

The lessons from PRSP-I implementation, the changed situation in Pakistan as compared to when the I-PRSP and PRSP-I were prepared, and the recommendations made in the studies outlined above, have all helped shape PRSP-II.

PRSP II is titled 'Ensuring a Demographic Dividend: Unleashing Human Potential in a Globalized World'. The term 'demographic dividend' is being increasingly used in development circles. Put simply, it refers to the opportunities for growth and poverty reduction presented by developing countries going through a transition from high population growth rates to lower ones [See Box 1]. Realizing the potential for a demographic dividend is not automatic. It requires foresight, planning and the implementation of suitable policies by government. The PRSP-II focuses on how Pakistan can unleash its demographic dividend.

As well as a shift of focus, the major change between PRSP-I and PRSP-II is in the number of pillars. PRSP-II retains the four pillars of its predecessor, but also has an additional three making seven pillars in total:

Pillar One: Drivers of Economic Growth and Macro-economic Stability

The Government is committed to continuing the strong economic growth and macro-economic stability of the past few years. The 'demographic dividend' offered by falling birth rates and increase in the working age-group can be realized through employment creation. Key drivers of growth include consumer finance, expansion of the agriculture sector, growth in manufacturing especially of the auto-industry, and the exponential rise of the services sector in particular telecommunications. The Government will continue reforms and programs to boost these drivers of growth. It will also pursue initiatives to promote exports and enhance competitiveness. These include: actively seeking expanded market access in the EU, US and other key markets; promoting Special Economic Zones (SEZs), industrial parks and the like; promoting education and skills development geared to meeting the needs of export-oriented industries. Particular stress will be placed on rural development and rural economic growth.

Pillar Two: Crafting a Competitive Advantage

The Government is committed to facilitating and enhancing the private sector to play a role in growth and development.

- This is to be done by: a) lowering the barriers to small and medium enterprises; b) encouraging a modern banking sector that expands lending; c) encouraging domestic investment; d) attracting foreign investment.
- The Government will provide public services and administrative frameworks to underpin private sector development, to supervise markets and to limit anti-

Box 1: Demographic Dividend³

The demographic dividend occurs when a falling birth rate changes the age distribution ... (it) makes for a smaller population at young, dependent ages and for relatively more people in the adult age groups—who comprise the productive labor force. It improves the ratio of productive workers to child dependents in the population. That makes for faster economic growth and fewer burdens on families.

The demographic dividend, however, does not last forever. There is a limited window of opportunity. In time, the age distribution changes again, as the large adult population moves into the older, less-productive age brackets and is followed by the smaller cohorts born during the fertility decline. When this occurs, the dependency ratio rises again, this time involving the need to care for the elderly, rather than the need to take care of the young.

In addition, the dividend is not automatic. While demographic pressures are eased wherever fertility falls, some countries will take better advantage of that than others. Some countries will act to capitalize upon the released resources and use them effectively, but others will not. Then, in time, when the window of opportunity closes, those that do not take advantage of the demographic dividend will face renewed pressures in a position that is weaker than ever.

The demographic dividend is delivered through several mechanisms:

a) Labor Supply

- The generations of children born during periods of high fertility finally leave the dependent years and can become workers (but good policies, preferably in place before the demographic transition, are required to educate and train them so they are not just unemployed).
- Women now have fewer children than before and are released to take jobs outside of the home; also they tend to be better educated than older cohorts and are therefore more productive in the labor force.

This assumes wise policies by government to create more jobs and seize upon the “dividends” of the changed age distribution—if they fail to do this, countries may struggle with the social unrest of millions of unemployed citizens.

b) Savings

- Working-age adults tend to earn more and can save more money than the very young. The shift away from a very young age distribution favors greater personal and national savings.
- The ability to save money is even greater when individuals born during periods of high fertility move into their 40s, when their own children are mainly on their own and require less support.
- Personal savings grow and serve as a partial resource for industrial investments that fuel economic growth.

c) Human Capital

- Having fewer children enhances the health of women. Their participation in the labor force, in turn, enhances their social status and personal independence. They tend to have more energy to contribute both to their families and to the society.
- Parents are under less strain to provide for many children. In surveys both men and women often cite economic pressures as their reason for using contraception.
- Family income can be focused more upon better food for infants, including girls, who are often given less to eat. Incomes can go toward prolonged education for girls, and for teenagers of both sexes to improve their life prospects.

³ Adapted from John Ross, ‘Understanding the Demographic Dividend’ (*Policy*, September 2004).

- competitive behaviour. Efforts will be made to improve corporate governance and enhance transparency.
- A policy of trade and market liberalization will be followed in order to encourage exports; sustained export performance is a key priority. Private and public barriers to investment will be reduced, and labour and land market reforms will be pursued. The Government sees competitiveness as the cornerstone of its economic growth strategy. Key elements in its approach to enhancing competitiveness are improvements in the education, nutrition and health of the population.
 - It will also implement a cohesive strategic plan for Special Economic Zones (SEZs); SEZs and industrial parks can generate employment, attract foreign investment, promote clusters, transfer technology and skills, and lead to increased exports.
 - Especial attention will be given to promoting competitiveness of the agriculture sector.

Pillar Three: Harnessing Potential of the People

Human resource development can play a major role in generating growth and poverty reduction. The Government is determined to harness the potential of Pakistan's people, and take advantage of the current 'demographic dividend'.

- Strengthening education provision is a major step towards human resource development. The Government will continue initiatives to improve education, e.g. Education For All, incentive packages for enrollment and to curb drop-outs. Governance of the education system will be improved through the National Education Assessment System (NEAS). Stress will also be put on higher education and promotion of a 'knowledge economy', as well as on skills development and vocational training.
- Especial attention will be given to gender mainstreaming and female human development. On-going initiatives to promote women's political representation, provide access to credit for women, prevent violence against women and implement gender budgeting will be continued.
- The Government recognizes that employment is the principal link through which economic growth translates into benefits for the poor. A number of targeted programs for employment generation are/will be implemented, e.g. President's Rozgar Scheme, and for provision of micro-credit.
- Particular efforts will be made to combat child labour.

Pillar Four: Financial Deepening and Economic Development

A wide-ranging reform program initiated by the Government in 2000 has led to considerable strengthening of the financial sector: seen in increased FDI, a booming stock exchange, robust banking sector, successful privatizations, and huge credit growth – all of which has contributed to the sustained growth of the past few years. The on-going challenge is financial deepening, i.e. financial development that includes not only expansion in the financial sector but also an improvement in institutions so that the financial system can allocate capital for more productive uses more efficiently. To this end, the Government will implement the following policies:

- Further consolidation and restructuring of the banking sector.
- Major focus on Development Finance to serve under-served markets.
- Further strengthening of the supervisory regime.

- Strengthening risk management.
- Encouraging greater depth and breadth in equity markets.

Pillar Five: World Class Infrastructure

Achieving the ambitious growth targets set by the Government will require massive infrastructure development. This is an essential part of the PRSP, and accounts for 54% of total planned development expenditure during 2005-10. The key to the Government's infrastructure development strategy is creating a conducive environment for private investment. An Infrastructure Project Development Facility (IPDF) has been set up to generate public-private partnerships. Specific plans include:

- Development and management of water resources – through creation of additional small- and medium-sized dams, integrated resource use, improved supply of clean drinking water and improved irrigation, better waste water treatment, and so on. In total Rs.270 billion has been allocated for the water sector under the PSDP 2005-10.
- Maintaining energy efficiency and security – completion of on-going power projects, and construction of massive storage dams, e.g. Bhasha-Diama, Kalabagh, Akhori to develop the country's massive hydro-electric power potential. Also implementation of the 2007 Petroleum Exploration and Production Policy, and construction of the Iran-Pakistan-India gas pipeline, approved by the Economic Coordination Committee and estimated to cost \$3 billion. The total investment in the power sector during 2005-10 is estimated at Rs.1102 billion, of which Rs.445 billion is to be mobilized from the private sector.
- Environmental conservation – implementation of the National Environment Policy to protect, conserve and restore Pakistan's environment through sustainable development.
- National Trade Corridor (NTC) – investment of some \$6 billion between 2005-10 to promote an integrated approach to planning and management of the national transport logistics system, in particular along the north-south NTC, thereby reducing transport costs, enhancing industrialization and export competitiveness.

Pillar Six: Effective Governance and Management

'First generation' reforms implemented by the Government include: financial sector reforms, capital markets reforms, tax and tariff reforms, reforms in tax administration, fiscal transparency, reforms in privatization program, governance reform especially devolution, and passage of the Fiscal Responsibility and Debt Limitation Act 2005. Over the next five years the Government will implement 'second-generation reforms':

- Institutional strengthening – reform of the judiciary, police, civil service and pensions, restructuring of the Central Directorate of National Savings and the Federal Bureau of Statistics, transforming the Monopoly Control Authority into a Competition Authority Organization, introduction of an E-government strategy.
- Improving competitiveness – strengthening the country's physical infrastructure, i.e. supply of gas and power, well functioning ports, roads, rail linkages, telecommunications network, and water availability.
- Second stage banking and financial sector reforms – including voluntary mergers and consolidations of smaller banks into bigger, more effective and strong banks; further strengthening of the legal infrastructure; formulation of a new Banking Law to deal with current and future challenges; promotion of transparency and accountability.

- Reinforcing devolution – including through: consolidation of fiscal decentralization by strengthening Provincial Finance Commissions; building local government capacity particularly in budgeting, planning, monitoring, financial management, accounting and audit; creation of a district service cadre; redefining Provincial Departments’ role from operational to regulatory.
- Promoting effective service delivery – by provincial and local governments; the Government will focus on better aligning accountabilities and expenditures, resources and policies across different tiers of government to improve social service delivery. Also increased spending on education and health sectors; governance reforms in the education sector; focus on preventive programs in the health sector.

Pillar Seven: Targeting the Poor and the Vulnerable

Assisting the poor and vulnerable is the key objective of PRSP-II. The main strategy of the Government to achieve this is social protection and provision of micro-credit. There are many programs for these already being implemented but they lack coordination. The Government hopes to address this issue and better target the poor and vulnerable by:

- Implementation of the National Social Protection Strategy – to develop an integrated and comprehensive social protection system. This entails: wider use of cash transfers (conditional and unconditional), a new public works program based on low-wage employment, child labour programs, scaling up school feeding and social care services, scaling down/eliminating the wheat subsidy.
- Improved targeting of benefits to the poor – maintaining current benefits, new means testing, development of databases in pilot areas, scaling up of successful pilots, extension of current benefits to the poorest of the poor, eventual adjustment of current benefits to higher levels and addition of new programs.

Micro-finance is an important instrument for poverty reduction and was promoted in PRSP I. While there are around 40 Microfinance Institutions of various categories operating across the country, there are barely 600,000 active borrowers. Current coverage reaches only 10% of the estimated 6 million households in need of microfinance. The Government plans to improve microfinance provision by:

- Moving away from subsidization of microfinance services to commercialization, i.e. away from government/donor subsidized credit delivery systems to self-sufficient institutions providing commercial finance.
- Encouraging the microfinance industry to move away from single to multiple products to ensure its sustainability, e.g. mobilizing savings through deposits and insurance provision.
- Reducing the administrative costs of microfinance provision by introducing market competition, innovation and efficiency.
- Enhancing access to credit by lower income groups.
- Ensuring that microfinance products are designed to fit the financial requirements of the people using them.

5. Pakistan Development Forum 2007

PRSP and the Demographic Dividend is the first substantive session (following the inaugural) in the 2007 Pakistan Development Forum. The Government will be using the opportunity to share the outline of the Poverty Reduction Strategy Paper II with its development

partners. The overall theme of the 2007 PDF reflects the focus of PRSP-II: unleashing the 'demographic dividend'.

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Session II: Domestic Commerce: Key to Propelling Growth and Job Creation – Background Brief⁴

Domestic Commerce

Domestic commerce is defined as the commercial activity happening within a society/country. It is basis of all growth and commercial development in a society. Importance of domestic commerce is based on three interrelated propositions discussed below⁵

Trade drives all production and innovation: When people lived in small villages, there was little need or incentive for mass production or innovation. For millions of year, humans lived in these small communities and there was no change. Subsistence agriculture remained the major occupation of mankind. It was only when commercial activity increased that people had incentive to produce and innovate and industrial revolution became a reality.

Local economic activity has been precursor of trade with other countries: It is difficult to find any example where commercial relations with outside lands have developed before relations with nearby villages and towns. Unless local trade is run efficiently, there cannot be much profit in foreign trade. History shows that countries which are big players in international trade, like UK, Japan or US, have always had an efficient domestic commercial setup.

Industries/companies which have succeeded locally have better chance of succeeding overseas: This has been true for all the major brand names in the world today. Coke, Pepsi, KFC, GE and McDonald first became household names in US and then ventured outside. Similarly, Sony, Toyota, Honda and Toshiba became a success story in Japan. Companies which can't survive the test of local demand, rarely succeed outside.

World history gives further evidence of the importance of domestic commerce. Industrial revolution started in England not because it had a powerful navy and had many colonies but

⁴ **Disclaimer:** This Background Brief has been prepared by Raja M. Ali Saleem for Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

⁵ PIDE *Policy viewpoint*, 'Promoting domestic commerce for sustainable pro-poor growth'. July 2006

because it had the proper atmosphere for domestic commercial activity⁶. Similarly, it's not a coincidence that Germany's industrial take-off and development coincides with its unification in the late nineteenth century. Unification created a big economic area with a large population ideal for domestic commerce while previously there were many small German states each zealously guarding its turf and thereby limiting commercial activity⁷. The Tokugawa era (1600-1868) is perhaps the best example of domestic commerce leading the development of a society because during this time Japan was completely closed to outside world. The seeds of Japanese future development were laid during this era by improving domestic commercial activity beyond proportions. Some of important reforms of this era were development of road networks, improvement of seed varieties and planting methods, use of proto-industrial production by merchant houses and channeling of river water flows⁸.

Domestic Commerce: Significance for Pakistan

Domestic commerce is important for all countries but it has an added significance for Pakistan because of the following reasons

Demographic Dividend Pakistan is the sixth most populous country in the world, with around a population of around 160 million. This large population can be thought of as a threat or it can be called demographic dividend and used to Pakistan's advantage⁹. China, and now India, are leveraging their huge populations to attract foreign investment of billions of dollars. But huge, young and unskilled population can be a disadvantage. In the current scenario, it is not a far fetched possibility that Pakistan can become unstable and a recruitment ground for terrorist organizations¹⁰. Domestic commerce can be the way out. Currently, it employs a significant proportion of population and most of people engaging in domestic commerce are poor and unskilled. If Pakistan can provide reasonable employment

⁶The following quote was given in a lecture on industrial revolution in England 'Under the reign of of just laws, personal liberty and property have been secure; mercantile enterprise has been allowed to reap its reward; capital has accumulated in safety; the workman has "gone forth to his work and to his labour until the evening;" and, thus protected and favoured, the manufacturing prosperity of the country has struck its roots deep, and spread forth its branches to the ends of the earth. [Edward Baines, *The History of the Cotton Manufacture in Great Britain*, 1835]'. <http://www.historyguide.org/intellect/lecture17a.html>

⁷ Road to national unification <http://www.colby.edu/personal/r/rmscheck/GermanyA3.html>

⁸ Encyclopedia article on Japanese industrialization <http://eh.net/encyclopedia/article/mosk.japan.final>

⁹ Durr-eNayab. 2006. 'Demographic dividend or threat to Pakistan'. *PIDE Working Paper* <http://www.pide.org.pk/pdf/Working%20Paper/Demographic%20Dividend%20Final.pdf>

¹⁰ Cohen, S. P. 2004. *The Idea of Pakistan*. Washington D.C: Brookings Institution Press

opportunities to its population, a nation of 100 million workers can change the world markets.

Urbanization Another reason for the importance of domestic commerce is that Pakistan urban population growth rate is one of the fastest in the world¹¹. In the past, people in rural areas survived of land but as more and more people shift to cities, state has to provide not only employment but also food, transport, infrastructure, health, education etc facilities. Unless domestic commerce picks up, this urban shift is difficult to be contained.

Services Sector growth Finally, services sector is now the biggest sector in Pakistan's economy. Almost half of the people employed are working in services sector and it has more than fifty percent share in country's GDP¹². Domestic commerce is the key to the growth of services sector. As unnecessary restrictions are lifted and regulations on business decreased, domestic commerce will increase, making services sector grow further.

Constraints on domestic commerce in Pakistan

I. Weak contract enforcement

Weak contract enforcement is a common problem in developing countries and Pakistan also suffers from it. Corruption and a weak judicial system are the main reasons behind it¹³. Cases linger on for years and it is difficult to predict even in clear cut cases which way the verdict will go. Out of a total of 175 countries, World Bank ranked Pakistan 163rd which means only twelve countries are worse than Pakistan in terms of enforcing contracts. Moreover, Pakistan is not progressing over the years. Pakistan was 163rd in 2005 and it is still 163rd in the latest ranking. Even looking at South Asian region, Pakistan appears a laggard. Although, Pakistan is ahead of India and Bangladesh, it is far behind Sri Lanka and Bhutan in enforcing contracts.

¹¹ AUICK website <http://www.auick.org/database/apc/apc014/apc01401.html>

¹² CIA World Factbook. <https://www.cia.gov/cia/publications/factbook/geos/pk.html#Econ>

¹³ Daily Times http://www.dailytimes.com.pk/default.asp?page=2007%5C04%5C06%5Cstory_6-4-2007_pg5_3

Country	Year	Enforcing Contracts ¹⁴			
		Rank	Procedures (number)	Time (days)	Cost (% of debt)
Bangladesh	2005	174	50	1,442	45.7
Bangladesh	2006	174	50	1,442	45.7
Bhutan	2005	102	34	275	113.8
Bhutan	2006	56	34	275	20.2
India	2005	173	56	1,420	35.7
India	2006	173	56	1,420	35.7
Pakistan	2005	163	55	880	22.6
Pakistan	2006	163	55	880	22.6
Sri Lanka	2005	88	20	837	21.3
Sri Lanka	2006	90	20	837	21.3

II. Obsolete Transport Networks

Transport infrastructure plays a critical role in the expansion of domestic commerce and economic growth of a country. It can bring costs down, save time and increase productivity. For example, studies have proved that domestic commerce increased due to the building of US interstate highway system, production and distribution costs decreased and productivity increased exponentially¹⁵. Although, Pakistan have increased its road network by thousands of miles in the last decade, its length and quality is still not sufficient for an economy which is ready to take-off.

Fiscal Year	High Type ¹⁶		Low Type		Total	
	Length	% Change	Length	% Change	Length	% Change
2000-1	144,652	4.7	105,320	-4.4	249,972	0.7
2001-2	148,877	2.9	102,784	-2.4	251,661	0.7
2002-3	153,225	2.9	98,943	-3.7	252,168	0.2
2003-4*	158,543	3.5	97,527	-1.1	256,070	1.5
2004-5*	162,841	2.7	95,373	-2.2	258,214	0.8

¹⁴ World Bank's cost of doing business database <http://www.doingbusiness.org/>

¹⁵ The interstate is fifty website <http://www.interstate50th.org/docs/techmemo2.pdf>

¹⁶ Board of Investment website <http://www.pakboi.gov.pk/BFacts/roads.html>

2005-6*	165,762	1.8	92,578	-2.9	258,340	0.1
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Pakistan's road density, which is called the index of prosperity and development, is only 0.32 km/sq.km while India's road density is three times more. After initial activity in the nineties, constructions of motorways have also stalled.

No.	Country ¹⁷	Road Density
1	JAPAN	3.07
2	UK	1.62
3	INDIA	1.00
4	USA	0.65
5	PAKISTAN	0.32
6	CHINA	0.15

Railways are in a much worse condition with dualization of track still a dream. Although, a modernization programme has been launched and new rolling stock has been added, freight traffic, the major source of revenue for railways, is not increasing much¹⁸.

III. Huge unmet demand for office and retail space

Availability of business space at reasonable rent is necessary for the growth of businesses. There is a huge demand of office space in Pakistan. The resulting high rental costs discourage many entrepreneurs from starting their own businesses. A new trend is usage of residential buildings as offices in major cities of Pakistan. This, in turn, results in other unfortunate consequences like increased traffic in residential areas resulting in accidents and noise pollution and increased time spent on road as most of the offices are far away from the central business district.

Demand for retail space also exceeds supply. Large departmental stores are now becoming visible but there still aren't many. Rents are high and people resort to encroaching on public

¹⁷ Board of Investment website <http://www.pakboi.gov.pk/BFacts/roads.html>

¹⁸ Economic Survey 2005-6 www.finance.gov.pk/survey/sur_chap_05-06/14-transport%20communication.pdf

spaces like corridors, sidewalks and even roads. It is difficult to walk in markets as every inch of space is being used as vending space.

State of our markets, office buildings, commercial plazas etc is another cause of concern. As new office space is not available to compete with their building, owners of buildings have no incentive to repair them. After every few months, there is a news item about crashing of a building in a marketplace¹⁹.

IV. Financing problems

Due to lack of depth of capital markets and crowding out by public sector, Pakistani businessman has always felt financing problems. Domestic commerce sector felt this crunch more so as financial sector didn't think domestic commerce sectors like retail as worth giving loans to²⁰. Even big firm faced problems in accessing capital. Another issue which limits financing opportunities is the high rate of interest. Pakistan had very high interest rates in the 1990s which made it impossible for firms to contemplate seeking loans and expanding their businesses.

V. Ill defined property rights

The famous Peruvian economist Hernando De Soto has linked property rights to growth of GDP. According to him when poor get property rights, they have an incentive to work hard. It also allows them to access capital which is otherwise denied to them. He calls for giving property rights of state lands to poor people²¹. In Pakistan, however, even if the property right are given to the poor, land mafia will snatch it from them with the help of land registration officers and police. There are several problems with our legal system dealing with land records. There are delay in registration, complex procedures of transferring land, benami laws, high transaction costs, loopholes in the registration act and high number of civil litigation in courts.²² Although, Pakistan ranks better than many regional countries in

¹⁹ The Nation <http://nation.com.pk/daily/sep-2006/3/>

²⁰ Faisal Farooq, CEO Nirala Sweets in M/o Commerce seminar on domestic commerce

²¹ [http://en.wikipedia.org/wiki/Hernando_de_Soto_\(economist\)](http://en.wikipedia.org/wiki/Hernando_de_Soto_(economist))

²² PIDE website <http://www.pide.org.pk/PSDE/news3.html>

registration of property, the important thing to note is that it is slipping down. In 2005, it was ranked 57 but in 2006, instead of improving, it dropped eleven places to 68.

Country	Year	Registering Property			
		Rank	Procedures (No.)	Time (days)	Cost (% of property value)
Bangladesh	2005	167	8	425	11
Bangladesh	2006	167	8	425	10.5
India	2005	108	6	62	7.9
India	2006	110	6	62	7.8
Nepal	2005	24	3	5	6.4
Nepal	2006	25	3	5	6.4
Pakistan	2005	57	6	50	3.4
Pakistan	2006	68	6	50	4.4
Sri Lanka	2005	119	8	63	5.1
Sri Lanka	2006	125	8	63	5.1

VI. Law and order situation

Pakistan is defined as a high political and security risk country. Law and order was not good in the past but after 9/11, terrorist threats and suicide bombing makes it very difficult for investors to bet their money on Pakistan. Pakistan's risk is even higher than countries like Sri Lanka, Myanmar, Zambia

Country	Rank in 2006	Composite Risk Rating 2006
Zambia	115	62.8
Bangladesh	117	62.5
Uganda	118	62.3
Sri Lanka	119	62.0
Guyana	120	61.8
Myanmar	122	60.5
Pakistan	123	59.8

Despite being offering a more open economy and fewer restrictions, Pakistan is far behind India, China and east Asian countries in foreign investment in retail and other sectors because of high political/security risk²³.

VII. Restrictive Regulatory Environment

The cost of doing business is high in Pakistan due to restrictive regulatory environment. Businesses have to comply with large number of regulations. These include labour laws, social security regulations, city regulations, tax rules and environmental laws. To unleash the true potential of domestic commerce, GoP has to reduce the number of laws/regulations a business has to conform.

Recent GoP Initiatives

I. Ministry of Commerce to focus on domestic commerce

While foreign commerce is paid great deal of attention, domestic commerce has been ignored by successive governments. Ministry of Commerce, which should be giving at least equal attention to domestic commerce, if not more, has been totally focused on improving foreign terms of trade and exploring new foreign markets²⁴.

Lately, however, government has acknowledged the importance of domestic commerce. Minister of Commerce said that domestic commerce would be given equal importance from now onwards. Ministry has taken several decisions to give domestic commerce its due importance

1. A new State of Commerce annual report will be published regularly which will focus on domestic commerce and help in developing data, making policies and taking informed decisions.

²³ Pak Tribune Editorial 'Attracting FDI' <http://www.paktribune.com/business/newsdetail.php?nid=110>

²⁴ http://www.tihp-undp.org.pk/docs/sem_lhr_02_02_06_dom_trade.doc

2. Ministry is also starting a new dialogue with private sector on domestic commerce.
3. Dialogue will also continue with provincial and district governments as they are critical in the growth of make domestic commerce.
4. Ministry will try to organize itself on the lines of US Department of Commerce /UK Department of Trade and Industry both of which give equal importance to domestic and foreign commerce
5. Ministry will also try to reduce regulatory restrictions on domestic commerce.

II. Devolution

History shows that domestic commerce flourished in areas where life and property are secure, commercial activity is given support and opinion of ordinary people are given importance. The devolution project started by GoP in 2001 is bringing improvement in all these areas. Political decentralization has brought government closer to people and more concerned about their views. Administration of cities is also more hands on and to increase the amount of local taxes, tehsil, town and district nazims have a personal interest in promoting commercial activities in their respective areas. A look at the current annual development programme of city government, Lahore shows that schemes have been started for improving roads, transport, community development, services, education, health, business promotion etc.

III. Access to Justice Programme and improved management of land records

Improvement in contract enforcement is necessary for securing investments and to decrease litigation. Government of Pakistan, with the help of Asian Development Bank, has started access to justice programme in 2001 to improve the judicial system in the country. This \$300 million programme is working in all four provinces. The major objectives of this programme are providing security and justice to the citizens, in particular the poor to enable them to secure and sustain entitlements and thereby reduce their vulnerability to poverty; strengthening legitimacy of state institutions; and creating conditions conducive to pro-poor growth especially by fostering confidence of investors. The achievements of this programme

include establishment of Federal law and justice commission for improving judicial policy-making, enactment of freedom of information law and Sindh consumer protection law, several measures to speedy disposal of cases like changes in high court rules and strengthening of monitoring mechanism for lower courts.

Improved management of land records will decrease many of the problem and delays people now face and remove discretionary powers from rent seeking revenue officials. Government of Punjab has started a Provincial Program for Land Records Management Information Management System (LRMIS) project to improve service in this vital area. The main objectives of this project are (a) to provide the necessary background on the functions performed by the BOR in relation to Land Records and revenue collection and its subordinate offices; and (b) assess the different procedures and business processes used for their core activities (e.g. land records, land administration system, etc.), and to consequently recommend substantive improvements²⁵. This project has already computerized the land revenue records of Lahore city as a pilot scheme. Other provinces and federal government are also planning to start similar projects²⁶

IV. Improving Mega cities

Cities are the engines of growth. Domestic commerce requires markets, offices, commercial spaces, roads, infrastructure to prosper and all these are the responsibilities of city governments. If city governments are not sensitive to the needs of its citizens and domestic commerce, then there is no hope of improvement. Government of Pakistan has, therefore, decided to give special attention to the development of big cities in Pakistan. Special packages has been announced by the President and Prime Minister for almost all big cities. Roads, markets, underpasses, sports and cultural facilities, clean drinking water and sanitation schemes, airports, parks etc. are being built with the help of Federal Government. Provincial governments are also working to improve cities in their provinces. Punjab has setup an Urban Sector Policy Management Unit to do research and develop policies for the

²⁵ PRMP Punjab <http://www.punjab-prmp.gov.pk/plrmis.htm>

²⁶ http://zameen.punjab.gov.pk/workshop_report.doc

improvement of its five biggest cities (Multan, Lahore, Rawalpindi, Faisalabad and Gujranwala). This unit has arranged large number of consultancies and workshops to collect data about these cities and suggested policy reforms in various areas to Punjab government for approval. Government of Sindh has also started a project, with the help of ADB, for the improvement of life and commerce in Karachi.

Road Ahead

Although government of Pakistan has started to move in right direction, there is lot to be done to overcome of more than fifty years of neglect. There is an urgent need to treat domestic commerce at par with industries to allow it to operate in a less restrictive environment. There is also a need to revise the zoning laws in big cities to make more office and retail space available for commercial activities²⁷. Further reforms are required in tax administration to decrease corrupt practices and to provide an enabling environment for domestic commerce. Business incubation services should be provided by the government to assist businesses to become established and profitable during their start up phase. Finally, it is vital that government acknowledge the potential of domestic commerce. Once domestic commerce potential is accepted, other actions will follow and domestic commerce will prosper.

Useful Resources

1. Economic Survey 2005-6 www.finance.gov.pk/survey/sur_chap_05-06/14-transport%20communication.pdf
2. PRMP Punjab <http://www.punjab-prmp.gov.pk/plrmis.htm>
3. AUICK website <http://www.auick.org/database/apc/apc014/apc01401.html>
4. CIA World Factbook.
<https://www.cia.gov/cia/publications/factbook/geos/pk.html#Econ>
5. Daily Times <http://www.dailytimes.com.pk/>
6. PIDE website <http://www.pide.org.pk/PSDE/>
7. World Bank's cost of doing business database <http://www.doingbusiness.org/>
8. The interstate is fifty website <http://www.interstate50th.org/docs/techmemo2.pdf>
9. Board of Investment website <http://www.pakboi.gov.pk/BFacts/roads.html>
10. Decentralization support programme www.decentralization.org.pk

²⁷ PIDE *Policy viewpoint*, 'Promoting domestic commerce for sustainable pro-poor growth'. July 2006

Session III: Rural Economy; Driver of Growth – Background Brief²⁸

Over the past 5-6 years Pakistan has enjoyed impressive macro-economic growth. However, there have been concerns about whether the benefits of this growth have been felt by all sectors of the population. Two-thirds of Pakistan's population lives in rural areas. Agriculture accounts for a significant proportion of exports and GDP. All these factors point to the importance of rural economic growth, both in driving overall growth and in bringing about real improvements in the life of the country's majority rural inhabitants. At the same time constraints on cultivated land and other natural resources point to the need for non-agriculture based rural employment opportunities.

This Background Brief examines the challenges in promoting rural growth, including constraints on agricultural productivity, water scarcity, lack of rural infrastructure and facilities, and outlines initiatives by the Government and Pakistan's development partners to address these issues.

1. Importance of the Rural Economy and Obstacles to Growth

The rural economy in Pakistan is dominated by agriculture: crop production accounts for approximately 59% of the sector, livestock some 37%. The importance of Pakistan's rural economy can be gauged from the following facts:

- Over two-thirds of the country's population live in rural areas;
- 45% of the labour force is employed in the agriculture sector;
- Agriculture accounts for 60% of exports and 22% of GDP;²⁹
- Poverty in Pakistan is predominantly a rural phenomenon: there are wide rural-urban differences in poverty levels and human development indicators.

These facts highlight the paradox in Pakistan that the rural economy is an important contributor to overall growth, yet rural populations are poor and deprived of quality services. Despite this paradox, the key to bringing about significant improvements in the lives of rural communities is to promote rural economic growth. The Government recognizes this. The first pillar of the Poverty Reduction Strategy Paper (PRSP) is 'achieving high and broad-based economic growth, *focusing particularly on the rural economy*, while maintaining macro-economic stability'.

Currently, growth of the rural economy in Pakistan is hampered by a number of factors. The remainder of this Brief examines these for different aspects of the rural economy – crop production, livestock, fisheries, and so on – and outlines the initiatives being taken by the Government to overcome them.

2. Agricultural (Crop) Productivity

²⁸ **Disclaimer:** This Background Brief has been prepared by Dr Iffat Idris for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

²⁹ All figures from *Vision 2030: Agriculture Chapter* (Planning Commission, Government of Pakistan).

The main crops grown in Pakistan are wheat, cotton, rice and sugar cane. The last three decades of the 20th century saw a substantial increase in agricultural productivity, brought about by improved rural infrastructure, use of high-yielding crop varieties (esp. rice and wheat), increased access to fertilizers and pesticides, incentives in the form of input subsidies, and other such factors. The country has achieved self-sufficiency in food production – no mean feat given the rapidly increasing population size – and surplus for export.

However, while Pakistan's overall productivity compares well to that of other countries and global averages, there are big disparities between large-holding, progressive farms and small farms. For example, while the global average yield of rice is 3,916 kg/hectare, average production in 'progressive farms' in Pakistan is 4,580 kg while the national average is just 2,882 kg.³⁰

A major factor in the low national average is the fact that 86% of farms are less than 12.5 acres in size. This leads to obvious loss of 'economies of scale', inefficiency, lack of resources for investment in land development, and so on. The problem is made worse by the country's inheritance rules, which mean the number of small farms is increasing as property is divided among multiple offspring.

Related to this is the problem of land distribution. Despite calls for and attempts at land reform since Pakistan came into being, ownership of land remains heavily skewed. While the majority of farms are small holdings, in terms of size much more land is in the form of large estates, owned by powerful landlords. In parts of Sindh and southern Punjab, in particular, these landlords operate in a feudal manner, exploiting local people and often denying them opportunities to gain education, access health care, etc. Most analysts agree that land reform is needed but to date no feasible options for this have been developed. Landowners, many of whom are also sitting in the legislative assemblies, oppose all attempts at redistribution. And the experience of countries like Zimbabwe, where forced land seizure and redistribution had a massively detrimental impact on agricultural productivity, has important lessons for Pakistan.

One of the biggest challenges ahead with regard to increasing agricultural productivity is the rapid shrinking of available water. This is discussed separately below, but one factor contributing to the scarcity of water is over-use of natural resources. This applies to land as well. Poor land management, excessive use of pesticides and fertilizers, too many private tube wells and other such practices are leading to decreased soil fertility, increased erosion and salinity, and an overall depletion of cultivable land. As Pakistan seeks to improve agricultural productivity, this has to be done in a manner that sustains natural resources and does not cause environmental damage.

Another problem farmers in many parts of the country face is a lack of infrastructure and systems to enable them to make the maximum profit from the crops they produce. Farm-to-market roads are often missing, farmers lack proper storage facilities, they do not have the means to transport produce to markets where they can get the best price, and so on – all leading to less income for small farmers. This has a knock-on effect as modern-day agriculture requires substantial up-front investment: in seeds, fertilizer, pesticides, tractors

³⁰ Ibid.

and other machinery. Small farmers with limited revenue struggle to mobilize the funds needed to enable them to realize the earning potential of their land. Many end up getting heavily into debt, leading to a vicious cycle of increasing debts and poverty.

These various challenges have to be dealt with against a backdrop of rapidly expanding population size and increased pressure on resources.

The Government is committed to increasing agricultural productivity. Its strategy focuses on improving rural infrastructure and water supply and management (see 5 below). It entails measures to maximize yields across the board, as well as specific steps to help small farmers. The strategy takes a holistic approach to agriculture, looking to improve crop production but also post-harvest management and marketing.

Initiatives by the Government include:

- Developing higher-yielding, disease-resistant crop varieties.
- Promoting use of best practices (and technology) in farm management, irrigation, use of fertilizers, pest management, etc.
- Providing easier access to micro-credit for small farmers, by identifying farmers' needs and capacity to utilize credit and targeting the flow of credit accordingly;
- Promoting sustainable use of natural resources.
- Promoting corporate farming by leasing out large tracts of state-owned uncultivated land to investors, and giving incentives such as rebates on stamp duty. This is expected to yield high quality produce, create job opportunities, exportable surplus and ensure international competitiveness.
- Distributing uncultivated state-owned land to small farmers, and giving them support in the form of infrastructure, micro-credit, etc. to make full use of it.
- Implementing a Crop Maximization Project to support poor farmers, e.g. with capacity-building.
- Abolishing restrictions on the import and export of all agricultural commodities, yet also protecting farmers against market volatility by supporting the price of wheat and providing indicative prices for others crops such as sugarcane, cotton and rice.

Note that the Government is particularly keen to target disadvantaged groups like women, minorities and landless labourers/tenants to enable them to generate income from farming. Special efforts are being made to mobilize these groups, provide them training, access to credit, land and other support.

By implementing these various measures, and improving rural infrastructure (detailed below), the Government hopes to increase overall agricultural productivity and at the same time ensure the benefits of this are felt by small farmers and rural communities. It also hopes to promote sustainable land use and protect the environment.

3. Livestock

The livestock sub-sector makes up a significant portion of the exports and GDP generated by the agriculture sector. Livestock provides 25-30% of the income of small farmers and landless livestock producers; it accounts for 9.7% of GDP but has tremendous potential for growth. Traditionally, the livestock sector in Pakistan has been dominated by small,

subsistence farmers to meet their needs for food, draught animals and to generate some cash income. Development has been constrained by a number of factors: inadequate and poor quality of feed; limited/negligible veterinary services; indiscriminate breeding of genetically inferior livestock; poor marketing facilities and infrastructure. Despite these constraints, the sub-sector has still been growing at an impressive 4-5% for the past few years.

The potential gains of developing the livestock sector are considerable. As compared to buying and farming land, rearing livestock is a relatively easy and cost-effective means for (landless) people to gain employment and generate income. Yields can also be greater: the value of milk, for example, is higher than that of the major crops. Empirical studies have shown that small farmers who combine livestock with crop production have twice as much income as those who only grow crops. Women can particularly benefit, because traditionally it is they who are engaged in rearing livestock and dairy production.

The Government's strategy to promote the livestock sector is focused on overcoming the constraints being faced and targeting women and vulnerable groups. As with crop production, it takes a holistic approach seeking to improve livestock production as well as processing and marketing of produce. Specific initiatives include:

- Breeding programs to improve the quality of livestock;
- Providing access to micro-credit, particularly to women;
- Developing and promoting the use of quality feed and fodder resources, and establishing feed mills;
- Improving disease control through vaccination campaigns, better disease surveillance systems and better veterinary services;
- Training and awareness-raising campaigns among livestock producers to promote best practices and curb bad practices;
- Improving the storage and processing of livestock products, e.g. with modern slaughter houses and chilling units;
- Providing better access to markets, and improving market infrastructure;
- Passing legislation to enforce the introduction of 'live animal on meat weight' basis, and end the exploitation of livestock producers by middlemen;
- Promoting the dairy industry with improved infrastructure, chilling and powder units, automated milk collection, dairy cooperatives, milk preservation techniques, credit facilities and endowment funds to help small producers, transportation facilities, and helping producers build their bargaining capacity to secure competitive prices for their produce.

The Government hopes that this combination of better livestock breeds, better quality feed, disease control, marketing and processing will enable more rural communities to generate jobs and income from livestock and thereby help alleviate poverty.

4. Fisheries

Fisheries are another important sub-sector. While its 1% of GDP contribution might not seem a lot, fishing is the most important source of revenue for poor coastline communities in Sindh and Balochistan. As with livestock, the fisheries sector has considerable potential for growth. Freshwater farming is already gaining momentum: more than 40,000 hectares

have been developed into fresh water farms in Punjab, Sindh and NWFP. Private hatcheries and farms have been set up in northern parts of Pakistan to expand trout fishing.

Currently, the fisheries sector is hampered by many of the same kinds of factors limiting crop and livestock production. Fishing boats lack modern equipment; storage and processing facilities are poor; access to markets can be difficult and market infrastructure is not well-developed; lack of capacity means fishermen do not realize the full revenue potential of their catch; over-fishing means fish stocks in some areas are declining.

If successes like those cited above are to be seen on a much bigger scale, constraints to fisheries growth will have to be overcome. The Government is committed to doing this, and has developed a strategy which both promotes the fisheries sector as a whole and specifically targets and benefits poor fishing communities. Interventions include:

- Revision of the Deep Sea Fishing Policy to increase the export of fish and fishery products, and to up-lift the socio-economic condition of fishermen.
- A marine fishing program which entails aquaculture development, upgradation of marine fisheries, surveys of fish stocks, improvement of post-harvest facilities (refrigeration and hygiene), upgradation of fisheries quality control laboratories, and EU-accredited processing units.
- Capacity-building, e.g. in processing fish catches, and other support, e.g. installation of GPS in fishing boats, processing equipment, to help boatless fishermen and small boat owners.
- Promotion of fish and shrimp culture in coastal areas of Sindh and Balochistan to increase their production and help poor coastal communities.

5. Water

Pakistan is one of the most arid countries in the world, receiving an average of just 240 mm rain per year. The rising population means per capita water availability has fallen dramatically: from 5,000 cubic metres per person in 1947, to 1,200 cubic metres currently. This is projected to fall to under 1,000 cubic metres by 2010. This makes Pakistan one of the most water-stressed countries in the world. Agricultural growth is dependent on water availability, but it has to compete with increased demand for limited water resources from industry and rapidly expanding populations.

Pakistan's water storage capacity is currently very limited. Both the United States and Australia have over 5,000 cubic metres of storage capacity per person; China has 2,200 cubic metres; Pakistan is way behind with just 150 cubic metres of storage capacity per person. Even the dams that have been built in Pakistan are dwarfed by those in other semi-arid countries. In the US, dams of the Colorado and Murray-Darling Rivers can hold a mammoth 900 days of average flow run-off. India can store between 120 and 220 days river flow, but Pakistan can store only 30 days run-off.³¹ Increasing storage capacity is important to build up stocks and enable more regulated release of water, particularly in times of shortage, and to generate hydro-electric power.

³¹ All figures for water availability and storage from *Pakistan Country Water Resources Assistance Strategy – Water Economy: Running Dry* (Report No.34081-PK, World Bank, November 2005).

As well as quantity, there are also issues with the *quality* of available water. Continued over-exploitation of groundwater, particularly by private farmers sinking tube wells, has depleted groundwater supplies and affected water quality. Salinity is a major problem – some 12 million tons of salt are added to the Indus basin each year; so too large-scale uncontrolled pollution of surface and groundwater by increased use of pesticides and fertilizers in agriculture, and rapidly expanding cities and industries. The accumulation of silt and other deposits in Indus system beds means rising water levels, leading to the danger of floods.

While there have been huge investments in new water infrastructure, neglect of maintenance means that much of this is in very poor condition. There is considerable seepage from water courses. A related ‘water management’ issue is the inefficient use of water. In irrigation, for example, the techniques used require considerable volumes of water; more water-efficient techniques such as laser leveling are available but are not being widely implemented. In sum, Pakistan is not making optimal use of the limited water it has.

The Government is cognizant of the looming water crisis facing the country, and is taking steps to avert this and ensure adequate supply of water to meet the requirements for rural growth. These include:

- Building new dams to increase storage capacity, ensure availability of water in times of shortage, and generate hydro-electric power. Work has started on construction of the Bhasha Dam in the Northern Areas. It will have an estimated capacity of 7.3 million MAF and is expected to generate 3,360 MW of power.
- Investing in integrated (irrigation, hydro-power, agriculture) water infrastructure.
- Improving the governance and management of the water sector.
- Lining water courses to prevent seepage and loss of water.
- Promoting the use of best practices in agriculture (e.g. more water-efficient irrigation techniques) and water use generally, to make optimal use of limited resources.
- Developing drought-resistant and water-use-efficient crop varieties to conserve water in agriculture.
- Promoting the sustainable use of water, to prevent degradation and environmental damage.
- Making productive use of salt-affected land that cannot be used for crop production, e.g. growing salt-tolerant trees and shrubs for use as fodder, or conversion to ethanol and methane.

6. Rural Infrastructure and Development

Currently, lack of infrastructure is one of the biggest constraints on growth of the rural economy. As seen, improvements in crop production, livestock and fisheries sub-sectors all require investment in new/improved infrastructure. Initiatives for improved infrastructure specifically geared to meeting the needs of agriculture, livestock and fisheries, e.g. markets, were described above. There are also ‘generic’ infrastructure needs, essential for promoting rural growth and development as a whole. Key among these are roads, electrification and improved services for education, healthcare, water supply and sanitation.

Roads are vital for improving access in rural areas, enabling produce to reach markets, and for the set up of commerce/industries that can generate jobs in rural areas. The

Government has started major projects for the construction of ‘farm-to-market’ roads across the country. Some 3,000 km of such roads have already been built. This is in addition to the large highways projects underway in different parts of the country, which will facilitate the wider movement of produce and open up rural areas for large-scale commercial ventures.

Electrification is important in agriculture, livestock production but has an even bigger role in improving the quality of life for rural populations and expanding their opportunities for employment and economic advancement, e.g. cottage-based industries. In this way electrification can have the knock-on effect of curbing migration from rural to urban areas.

There are significant challenges involved in the electrification of rural areas. Low population densities, remote areas, limited demand all make rural electrification a costly and commercially unviable venture. The Government is cognizant of this and has launched a rural electrification program under which electricity supply is being brought to some 15,000 villages.

Investment in infrastructure and economic growth will only yield maximum results when accompanied by investment in rural services. Currently, there are significant gaps in rural-urban access to services like education and health care, and subsequently in rural-urban human development indicators. Some of the major constraints on rural service delivery are: lack of staff, with qualified people being reluctant to work in remote areas; lack of female staff; lack of facilities; poor state of facilities; staff absenteeism; lack of funds and poor management. The establishment of a third tier of local governments, responsible for delivery of basic services, was a major initiative by the Government to overcome these issues. Devolution has led to some improvements, but many issues such as lack of capacity of service providers, remain. The Government is committed to overcoming these, and is undertaking various initiatives to improve access to and the quality of services in rural areas.

7. Initiatives by Development Partners

Several of Pakistan’s development partners are supporting various aspects of rural development and growth. Some interventions focus on particular aspects of the rural economy, e.g. crop production, while others are geared towards creating the general conditions needed for growth, such as roads and services.

The Asian Development Bank (ADB) has put particular stress on agriculture and rural development: ‘Given that 75% of Pakistan’s poor live in the rural areas, ADB’s strategy targets assistance for rural development with a focus on improving the policy and institutional framework, increasing agriculture productivity and diversification, increasing non-farm employment opportunities by developing agribusinesses, improving communications and rural roads, expanding rural infrastructure and promoting financial intermediation.’³²

ADB’s Country Strategy and Program for Pakistan 2002-6 provides support in seven areas, one of which is agriculture and rural development. This accounts for 13% of total resource

³² www.adb.org/Documents/News/PRM/2002/prm_200202.asp

allocations, which are an estimated \$800 million annually.³³ ADB has numerous projects designed to promote rural development and growth. The \$140 million Farm to Market Roads Project helped turn almost 2,000 km of unpaved rural tracks into paved roads, leading to more land being cultivated in the project areas, more crop production as well as improved access to services. The Malakand Rural Development Project includes interventions for building roads, building capacity in poultry farming and other small enterprises, small infrastructure projects such as tube wells, improved facilities and access to credit – all designed to enable rural communities in the project areas to lift *themselves* out of poverty.

The World Bank is supporting similar projects across Pakistan. The Balochistan Community Irrigation and Agriculture Project, for example, provides improved irrigation systems and piped drinking water to some 7,000 poor families farming 4,800 acres of land in south-west Balochistan. The project is helping bring about assured water supply for agriculture, leading people to develop commercial orchards and greatly increase their income. The Pakistan Poverty Alleviation Fund (PPAF), to which the World Bank is a major contributor, has funded over 3,400 small infrastructure projects, e.g. for tube wells and paving small roads, besides giving micro-credit to tens of thousands of poor people.

There are many other such projects being implemented by other donors, as well by civil society organizations. While they are having a positive impact on their target areas, the current massive scale of rural poverty and rural under-development shows there is a pressing need for more to be done. Pakistan's development partners can support Government initiatives to promote rural growth through funding and technical assistance.

8. Pakistan Development Forum 2007

The Pakistan Development Forum 2007 has a session dedicated to the 'Rural Economy as a Driver of Growth'. Perhaps the key issue to be examined in the session is how to promote agricultural productivity but do so in a manner that is sustainable and does not cause environmental damage? Given Pakistan's limited natural resources, an equally important issue will be how to promote non-agriculture based rural job creation and income generation? The session will be chaired by the Federal Minister for Food, Agriculture and Livestock and will feature inputs by experts with a broad range of experience. The session aims to identify options to address the challenges faced in promoting growth in the rural economy, and ways in which Pakistan's development partners can support the process.

9. Useful Sources

Asian Development Bank: www.adb.org.pk

Government of Pakistan. *Poverty Reduction Strategy Paper: Accelerating Economic Growth and Reducing Poverty: The Road Ahead*. Government of Pakistan, December 2003.

Government of Pakistan. *Vision 2030* (chapter on Agriculture). Planning Commission, Government of Pakistan.

World Bank. *Pakistan Country Water Resources Assistance Strategy – Water Economy: Running Dry*. Report No.34081-PK, World Bank, November 2005.

World Bank: www.worldbank.org.pk

³³ Ibid.

Introduction

Since the late nineteenth century, politicians, economists, historians etc. have been perplexed why some countries grow and other lag behind in economic growth. In 1956, Solow presented a neo-classical model of economic growth. In this model, output was determined by only capital and labour and technology was exogenous. The problem with this model was that it didn't stand the test of actual data. The cross-national experiences were varied and couldn't be explained by this model. A key prediction of this model which failed to materialize was that poor countries will grow faster and catch up with rich countries and then a steady state will be achieved.

For the next thirty years, economists tried to improve Solow growth model but the efforts were not successful in explaining growth. In 1986, Romer and then Lucas came up with an endogenous growth model. This model is called endogenous because technology is dealt endogenously in this model. This change helped explain why the differences between poor and rich nations are not disappearing. Technology or the stock of knowledge of a nation plays a critical part in economic growth of a nation. This stock of knowledge is not physical machines but human capital. Only human capital interactions result in 'intellectual spillovers' which lead to continued growth. But which are the best places for these intellectual spillovers to happen? Experts agree that cities, with their dense, urban environment and relatively educated populace, are the best places where spillovers can take place, leading to economic growth and development.

According to one estimate, urban areas in developing countries will be recipient of more than ninety percent of the world's population growth. Intellectual spillovers, discussed above, will have effect only in cities which are well administered. These kind of cities will become engines of growth and will promote human prosperity and peace. But another scenario is

³⁴ **Disclaimer:** This Background Brief has been prepared by Raja M. Ali Saleem for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

also possible. If developing countries can't manage their cities, there will be riots, violence, environmental degradation, epidemics and water wars³⁵. The ethnic conflict in Karachi is a failure of our urban management and can be a precursor of similar happenings in other cities.

Background and Policy Framework

The high rate of urbanization (4.5%) in Pakistan is alarming, if we compare it with the rate of urbanization (around 2%) in other developing countries. Currently, about one-third of the people of Pakistan live in cities but by 2030, this proportion will increase to almost fifty percent³⁶.

DENSITY AND URBAN/RURAL PROPORTION BY ADMINISTRATIVE UNITS³⁷

Administrative Unit	1998 Population		Population Density per Sq. Km.Proportion.....	
	Number	Percentage		Urban	Rural
PAKISTAN	132352279	100.00	166.3	32.5	67.5
N W F P	17743645	13.41	238.1	16.9	83.1
F A T A	3176331	2.40	116.7	2.7	97.3
PUNJAB	73621290	55.63	358.5	31.3	68.7
SINDH	30439893	23.00	216.0	48.8	51.2
BALUCHISTAN	6565885	4.96	18.9	23.9	76.1
ISLAMABAD	805235	0.61	888.8	65.7	34.3

It is clear that Pakistan's future is linked with the future of its cities. If we can manage the growth of population in these cities, this growth will be another example of demographic dividend which has put countries on high growth trajectory. If we fail, Pakistan can become a 'failed state' as many in the world are predicting³⁸.

³⁵ USAID. Making cities work <http://www.makingcitieswork.org/e>

³⁶ UN Report <http://www.un.org/esa/population/publications/wup2003/WUP2003Report.pdf>

³⁷ Census Organization <http://www.census.gov.pk/AreaDensity.htm>

³⁸ <http://www.freemuslims.org/news/article.php?article=414>

Cities are a focus of economic activity and provide majority of employment in value-added sector. Cities are not only a combination of physical infrastructure for communities but they also provide social infrastructure like culture, traditions, behavior and folklore. Each city has a distinct physical and social infrastructure. Even cities, which are joined together by growth like Rawalpindi and Islamabad, maintain their separate outlooks. Dynamism of cities lead them to innovate and renew. Cities, which are dynamic survive and grow while others stagnate and die.

In Pakistan, cities were never recognized as separate entities. Although, there were mayors and city councils in big cities, mostly it was the provincial government whose writ and opinion prevailed. Elections for mayors were indirect so mayors were chosen by the provincial chief executive and city councilors were told to vote for them. Budgets and development schemes were also made in federal and provincial capitals so it was very difficult for city leadership to have any input in them. On the other hand, provincial bureaucracy had very little idea what specific problems a city had, so the projects approved were mostly unsuccessful.

Policy Framework: Federal Government has not made any policies of significance to deal with urbanization or urban planning in the last sixty years. Urbanization and its effects have been neglected even when Pakistan is being urbanized at a great speed. At the federal level, initially, ministry of environment and urban affairs had the responsibility of dealing with urbanization. This ministry mainly focused on environment and urban affairs were ignored. In 1996, in an austerity drive, this ministry was merged into the ministry of local government and rural development. The new ministry came to known as ministry of environment, local government and rural development. The useless attachment of 'urban affairs' was dropped. Urban affairs which was not given importance in a separate ministry, was completely forgotten in the combined ministry. In November, 2002, the two ministries were again divided and ministry of environment became a separate ministry. But again environmental issues are at the central stage and urban problems are still ignored. There is no separate wing dealing with this issue as is clear from ministry's organization chart and almost all the developmental projects relate to environment. In this atmosphere of neglect, it is no surprise that there are no policies dealing with urbanization/ urban problems.

Medium Term Development Framework (MTDF) MTDF was made by the GoP to have a comprehensive medium term strategy. It is a five year plan covering the period from 2005 to 2010. MTDF talks about the need of urban development and preparation of a urban development strategy to deal with issues like land management, poverty, housing, environment, water supply and sanitation, transport etc. There is also a call of more community participation and public-private partnerships in urban improvement projects. A research centre 'Urban Policy Research Centre' is also to be established to do quality research on urban issues. However, after two years of the start of this programme, most of these suggestions are still suggestions. There is no urban development strategy and no urban policy research centre³⁹.

Provincial government policies: Perhaps, it is better that there are no federal government urban policies because it allows provinces to take the lead on an issue which Constitution of Pakistan has assigned to them. Different provinces have dealt with the need of an urban policy in different ways. Punjab has no separate urban policy but has come up with a poverty focused investment strategy (PFIS), which also covers housing and urban development. PFIS first talks about the urban problems in Punjab and then responsibilities of various agents in tackling with them. These agents include provincial, district, town and tehsil governments, cantonment boards, international donors, Civil society organizations etc. Finally, it enumerates the projects and plans which Punjab government is going to implement in near future⁴⁰. Although, bits and pieces of policies dealing with urbanization issues are available, Sindh, Balochistan and NWFP do not have an urban development policy⁴¹.

³⁹ Planning Commission MTDF <http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf/Foreword,%20Preface%20and%20President%20Message/Overview.pdf>

⁴⁰ Poverty Focused Investment Strategy [http://www.punjab-prmp.gov.pk/pfis/Documents/PFIS.Main.Report.Final.Version\(Volume-I\).pdf](http://www.punjab-prmp.gov.pk/pfis/Documents/PFIS.Main.Report.Final.Version(Volume-I).pdf)

⁴¹ NWFP Local government department <http://www.nwfp.gov.pk/AIS-page.php?DistId=1&DeptId=11&LanId=1&pageName=Main>

Challenges for government & cities

Lack of policy

As it is clear from above, there is no integrated and comprehensive policy available for urbanization related issues in this country. Governments, both at the federal and provincial level, are dealing with the various issues separately. Traffic problems, sanitation, urban slums, and waste management are dealt by separate government departments, although they are inherently linked. A common scene replicated in Pakistani cities again and again is a new road, which took a year to built, plowed by one after another department for putting in pipes, wires etc. Within six months, new road resembles the old one it replaced. Our cities are in a mess because we haven't tried to look at them as a whole. An integrated urban policy is the need of the moment.

Urban slums

Slums are a part of every major city in developing world and Pakistan is no exception. This phenomena is a result of high population growth, migration from rural areas, high cost of land and lack of low-cost housing. According to experts, more than thirty percent of the population of big cities in Pakistan lives in katchi abadis⁴². Without basic amenities and in constant fear of being uprooted, life in these slums is miserable to say the least. These slums are the breeding grounds of crime and epidemics which not only affect them but the country.

Provision of potable water and sanitation

Provision of clean drinking water and sanitation is another issue which needs government's attention. Prevalence of various forms of Hepatitis virus in our society is reaching epidemic proportions. Hepatitis C is referred in medical journals as a "Silent Epidemic" since it usually progresses slowly over many years. Most people who are infected with hepatitis C don't know about it even after years. According to Pakistan Journal of Medical Sciences, there are approximately four million people infected and about eight to ten thousand die annually⁴³. One of the main reasons for prevalence of this epidemic is contaminated water. Pakistan needs to urgently overhaul drinking water and sanitation system in its cities.

⁴² Pakistan EPA, State of Environment report, 2005 <http://www.environment.gov.pk/pub-pdf/StateER2005/Part3-Chp%204.pdf>

⁴³ Pakistan Journal of Medical Sciences www.pjms.com.pk/issues/julsep02/article3.html

Solid Waste disposal

Municipal Solid Waste (MSW) is useless or unwanted material discarded as a result of human or animal activity. Most commonly it is solids, semisolids or liquids in containers thrown out of houses, commercial or industrial premises. The problem in Pakistan is that there is no municipal solid waste management. There is irregular collection of waste so we have huge heaps of waste lying in streets, breeding ground for various diseases. Waste collected is then burnt to reduce its volume and to lengthen the life of dumpsite. This results in smoke, bad smell, eye and lung infections, wastage of land which can be used productively and loss of valuable recyclable materials⁴⁴.

Traffic hazards

Traffic hazards are another consequence of fast growth of urban populations. The number of roads has not grown as fast as number of vehicles, leading to traffic congestion and accidents. Absence of a proper public transport system, illiteracy, lack of traffic sense and corruption in traffic police also add to the problem. There is an increase in road traffic accidents in the whole South Asian region as increasing economic growth allows more people to buy cars. Almost all of these road traffic accidents are preventable and these not only affect the families concerned but also the whole economies. According to WHO estimates, road traffic accidents cost countries between 1 to 2% of their GDP⁴⁵.

Lack of proper housing

Housing problems are worsening in Pakistan due to continued lack of interest of federal and provincial governments to tackle this issue. Already, there is more than five million unit shortfall of houses around the country. Add to this, more than thirty percent of houses

⁴⁴ WWF, Pakistan www.wfpak.org/factsheets_mswf.php

⁴⁵ College of physicians and surgeons Pakistan
<http://www.cpsp.edu.pk/JCPSP/ARCHIEVE/Dec2004/Article4.pdf>

which are made of unbaked bricks, so would not provide proper protection to their residents. Some experts have even termed the situation in Pakistan as a housing crisis⁴⁶.

The problem has been aggravated by housing not regarded by the government as its responsibility and by the lack of investment opportunities in the country. For the last two decades, real estate has been our major area of investment which has resulted in skyrocketing of land/house prices. One solution is government constructing low-cost houses itself or in public-private partnership. Another solution is the government providing soft loans to people for the construction of houses and the interest rate on loans given by the House Building Finance Corporation should be reduced⁴⁷.

Hazard Risk Management

Recent earthquake, floods and terrorist attacks have shown us the necessity of improving hazard risk management in our cities. According to World Bank, developing countries suffer more when disaster hits them. More than ninety five percent of all deaths caused by disasters occur in developing countries. Losses in developing countries are also twenty times greater, as a percentage of GDP,) in developing countries than in rich countries⁴⁸. It is important that government devise a plan for disaster management for each city.

GoP Initiatives

GoP has started various steps to improve the quality of life in the urban centres of Pakistan. The most important of these initiatives is devolution

Devolution

The devolution exercise carried out by the GoP in 2001 has brought about a sea of change in the management of cities. Instead of deputy commissioners, city council and mayors, we now have nazims and district and town assemblies. Devolution has no doubt

⁴⁶Jacobsen, Kurt. 2002. 'Building a foundation:poverty, development and housing in Pakistan'.
http://goliath.ecnext.com/coms2/summary_0199-1372549_ITM

⁴⁷ Daily Times Report http://www.dailytimes.com.pk/default.asp?page=story_14-12-2003_pg7_19

⁴⁸ World Bank
<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTURBANDEVELOPMENT/EXTDISMG/MT/0,,menuPK:341021~pagePK:149018~piPK:149093~theSitePK:341015,00.html>

increased popular participation in local government but it is still difficult to conclude what effect devolution has on management of cities. However, one conclusion can be drawn by looking at international best practices, it would have been much better to have directly elected nazims at district level so that they are answerable to ordinary people.

The important research questions which have to answered are as follows:

- What policies have provincial and local officials formulated in response to the 2001 Local Government Ordinances, and how are these policies carried out by executing agencies staff in cities?
- What are the effects of devolution on poverty and employment in cities?
- Has devolution increased ownership of developmental projects in residents of cities?
- Has success rate of projects changed after devolution? If yes, what are the reasons for this change?
- How have low-income urban residents fared in the new environment? Which groups are better and worse off?
- How have social and economic conditions in big cities changed since 2001? In particular, how have poor neighborhoods fared?

Urban Sector Policy Management Unit

Provincial governments are also working to improve cities in their provinces. Punjab has setup an Urban Sector Policy Management Unit to do research, provide financing and develop policies for the improvement of its five big cities (Multan, Lahore, Rawalpindi, Faisalabad and Gujranwala) of Punjab. Recently, urban unit signed an agreement to finance a pilot project for provision of water supply and sanitation facilities in Lahore through community participation. Under this agreement, urban unit would fund putting in place trunk infrastructure of water supply and sewerage, besides installation of tube-wells and construction of disposal stations⁴⁹.

⁴⁹ City Government, Lahore website <http://www.lahore.gov.pk/news/english/english-news.aspx?id=205>

This unit has arranged large number of consultancies and workshops to collect data about these cities and suggested policy reforms in various areas to the Punjab government.

Punjab Municipal Development Fund Company

There was a growing realization in Punjab that municipal development needs assistance in terms of soft long term loans for renewing their dilapidated infrastructure and other big projects. Support from provincial budget was not available and private sector charged too high rate of interest. It was, therefore, decided that there should be a separate agency for municipal development in the province so Punjab Municipal Development Fund Company (PMDFC) was established in 2005. PMDFC has been established under section 42 of the Companies Ordinance 1984, with an autonomous governance structure. Majority of the members of the board of directors are from the private sector. PMDFC is currently not only providing financial assistance to the newly established local councils but also helping them in capacity building and providing managerial support in GIS, town planning and social mobilization⁵⁰.

Donors-assisted Projects for Urban Uplift

GoP has also started some projects with donors to extend basic amenities to urban residents, to decrease environmental degradation and to decrease poverty in urban centres.

Recently, GoP has agreed with ADB to start **Mega City Sustainable Development Project in Karachi**. The total cost of this project is 215 million dollars and it will be funded by a loan from the ADB. This project will try to improve the environmental and living conditions of the residents of Karachi. It is hoped that this project will also enhance urban productivity through the provision of critically needed urban infrastructure and services. Another important ongoing project, with a vast scope, is the **NWFP Urban Development Sector Project**. The total cost of the project is around twenty million dollars which is being funded by an ADB loan. The project is covering twenty four urban centres in NWFP. Its objectives are to (i) demonstrate effective interventions in urban service management that can be replicated; (ii) stimulate a progressive shift of responsibilities to urban local

⁵⁰ PMDFC <http://www.pmdfc.org.pk/gis.htm>

governments for financing and management of urban services; and (iii) improve management and resource mobilization capacities of urban local governments. It was started in October 2002 and will continue till next year.

Punjab Community Water Supply and Sanitation Sector Project costs are around fifty million dollars and it is also funded by an ADB loan. This project was started in April 2003 and as is clear from the name of the project, this project intends to improve water supply and sanitation in Punjab. The specific objectives of this project are: (i) Extension of water supply, drainage, and sanitation coverage to village communities that do not have access to organized water supply and are located in the brackish and barani areas of the Province by using a community based demand driven approach. Initially, this project will focus on 54 priority tehsils in 26 districts, later it will include all areas in Punjab; (ii) Promotion of household latrines and hygiene education; (iii) Implementation of a Social Uplift and Poverty Eradication Program for establishing income generating schemes through a micro credit system and acceleration of school enrolment; and (iv) institutional strengthening and capacity building of participating newly constituted local Government institutions and community based organizations. poverty level is much higher in Southern Punjab than in Northern or central Punjab. It was, therefore, important to start some specific schemes to improve the conditions in this area. **Southern Punjab Basic Urban Services Project** was started in 2003 with a 90 million dollars loan from ADB. The main objectives of the project are to (i) reduce urban poverty, improve community health, and related environmental degradation in 21 Project towns by improving water supply, sanitation, solid waste management, and roads for low-income communities; and (ii) ensure sustainability of urban investments by strengthening institutional capacities of newly devolved local government municipal agencies. Work on this project is going on schedule.

Another important project going on in Punjab, with the help of ADB is **Rawalpindi Environmental Improvement Project**. It was in December 2005 with a 60 million dollars loan from ADB. The main objectives of the project are (i) improving living conditions and quality of life of the people of Rawalpindi by improving the water supply and sanitation facilities, solid waste management, wastewater treatment, and slaughterhouse; and (ii) ensuring sustainable urban investments by strengthening institutional capacities of the Rawal

Town (RT) and Rawalpindi Water and Sanitation Authority (WASA), promoting policy reforms focused on greater devolution of authority, and involving all stakeholders in service delivery.

World Bank has also agreed to finance several projects related to urban settlements. Two of most important projects in this regard are Punjab Municipal Services Improvement project and NWFP Community Infrastructure project II. **Punjab Municipal Services Improvement Project** was started last with a 60 million dollars loan from World Bank. This project will help improve the viability and effectiveness of urban services provided by the participating Tehsil Municipal Administration (TMAs), and to make such improvements sustainable and replicable in other TMAs. The first NWFP Community Infrastructure project was very successful so it was decided to continue this project in other areas and **NWFP Community Infrastructure Project II** was approved in May 2004. The total project costs are 53.3 million dollars which are provided by the World Bank as a loan. Initially, the objectives of the project were to improve community infrastructure in other areas but then on October 8, the earthquake struck and there was vast devastation in NWFP. This led to changed focus of the project to provide financial assistance to support the recovery, reconstruction and rehabilitation of communities devastated by the earthquake.

Useful Resources

1. Ministry of Local Government and Rural Development
<http://www.pakistan.gov.pk/divisions/index.jsp?DivID=45&cPath=618>
2. National Institute of Urban Affairs http://www.niua.org/research_studies_2006.asp
3. USAID Making Cities Work
http://www.makingcitieswork.org/urbanWorld/A&NE/A&NE_page
4. Medium Term Development Framework
<http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf/15-Rural%20and%20Urban%20development/15-Rural%20&%20Urban%20development.pdf>
5. Punjab Resource Management Programme <http://www.punjab-prmp.gov.pk/>
6. Poverty Focused Investment Strategy [http://www.punjab-prmp.gov.pk/pfis/Documents/PFIS.Main.Report.Final.Version\(Volume-I\).pdf](http://www.punjab-prmp.gov.pk/pfis/Documents/PFIS.Main.Report.Final.Version(Volume-I).pdf)
7. Urban Resource Centre, Karachi <http://www.urckarachi.org/>
8. Balochistan Resource Management Programme <http://www.brmp.gov.pk/>
9. Punjab Local government department <http://www.punjab.gov.pk/lg-rd/index.html>

10. Balochistan Local government Commission
http://blgc.org.pk/AISBALOCHISTAN/AIS-page.php?pageName=b_lgc_fun
11. Sindh Local government department <http://www.lgdsindh.com.pk/>
12. NWFP Local government department <http://www.nwfp.gov.pk/AIS-page.php?DistId=1&DeptId=11&LanId=1&pageName=Main>
13. Pakistan EPA, State of Environment report, 2005
<http://www.environment.gov.pk/pub-pdf/StateER2005/Part3-Chp%204.pdf>
14. World Bank, Pakistan
<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/PAKISTANEXTN/0,,menuPK:293057~pagePK:141159~piPK:141110~theSitePK:293052,00.html>
15. ADB, Pakistan www.adb.org/pakistan/
16. PMDFC website <http://www.pmdfc.org.pk/aboutus.htm>

Session IV: Financial Deepening and Development – Background Brief⁵¹

Introduction

The link between financial deepening and economic growth is well established since the early seventies. What is still being debated is which causes which? One group of economists believes in ‘supply-leading’ hypothesis. They argue that financial deepening is one of the pre-requisites of economic growth. Not surprisingly, they want developing countries to improve their financial services as soon as possible. IMF and World Bank have a large majority of such economists. The other group believes in ‘demand following’ hypothesis. They contend that financial deepening follow economic growth. As a country grows, its financial services will expand and new instruments will develop as the need arises. There is no need to waste efforts on something which is to be used five years down the road⁵².

Definitions of Financial deepening

1. A term used to describe the development and expansion of financial institutions ' such as banks, stock markets, and insurance companies ' relative to the size of a country's economy.

Center for Popular Economics⁵³

2. Financial deepening refers to the increased provision of financial services with a wider choice of services geared to all levels of society.

Wikipedia⁵⁴

3. Financial Deepening is the process of developing the financial sector available to poor communities through the services of the private sector.

Financial Deepening Challenge Fund⁵⁵

⁵¹ **Disclaimer:** This Background Brief has been prepared by Raja M. Ali Saleem for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

⁵² Citeseer <http://citeseer.ist.psu.edu/update/522735>

⁵³Center for Popular Economics website <http://www.populareconomics.org/>

⁵⁴Wikipedia http://en.wikipedia.org/wiki/Financial_services

⁵⁵ Financial Deepening Challenge Fund
<http://www.financialdeepening.org/default.asp?id=700&ver=1>

According to 'supply-leading' hypothesis, financial deepening has the following beneficial effects on economic growth and development.

Less intermediation costs: In poor countries, there are large fixed costs to enter the formal financial system and marginal costs of subsequent transactions. Such costs shut out a large of people from getting the benefits (such as low interest loans) of the formal financial system. As financial intermediaries develop, the credit supply process improves and costs come down, making financial services affordable for a large number of people. Some studies have also shown that financial intermediaries exert a positive influence on factor productivity growth which leads to economic growth⁵⁶.

Less government interference and better allocation of capital: It is well established that government interference in the working of financial sector leads to distortions and restricts the growth of financial markets. Government interference in poor countries usually takes the form of subsidized credit, high required reserve ratios, credit rationing and ceilings on deposits. This results in a segmented credit market where loans are given at low interest rates to favoured sectors while others have to obtain loans from high cost informal markets. As financial reforms and financial deepening occur, directed credit is phased out. Interest rates are determined by the market forces and capital moves to sectors where rate of return is high. This, in turn, leads to bigger profits and higher growth⁵⁷.

More capital accumulation: Some economists have argued that financial diversification leads to more capital accumulation, thereby helping economic growth. They posit that financial liberalization has a positive effect on savings as more people find the specific mix of risk and reward they want in their saving instrument. Moreover, as explained above, when better investments are made and rate of return is high, more people will defer consumption and

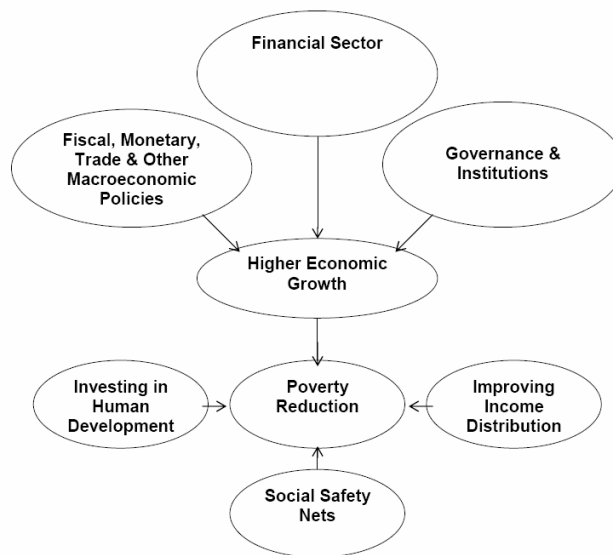
⁵⁶ Khan, Mohsin S. & Abdelhak S. Senhadji .2000. 'Financial Development and Economic Growth: An Overview'. *IMF Working Paper* 209. Washinton DC: IMF Institute

⁵⁷ Husain, Ishrat. 2004. 'Financial sector reform and pro-poor growth: The case study of Pakistan'. Presidential Address at the Annual General Meeting of the Institute of Bankers Pakistan held at Karachi on February 21, 2004
<http://unpan1.un.org/intradoc/groups/public/documents/APCITY/UNPAN020765.pdf>

save to earn high profits. This increases capital accumulation which is a requisite for economic growth⁵⁸.

Economic growth, however, is not an end in itself. Poor countries want to grow to lower poverty. A schematic diagram below shows that link between financial sector reform and poverty reduction.

A schematic diagram of linkage between Financial Sector and Poverty Reduction



Reform Initiatives in recent years

Financial services sector in Pakistan has been revolutionized during the last decade and a half. It is impossible to discuss all the financial deepening reforms here so only important measures are discussed in the following section.

Privatization of nationalized banks and liberalization of banking sector

Not more than a decade ago, around ninety percent of banking assets in Pakistan were in public sector. Now, more than two-third of these assets are in private sector. Foreign banks

⁵⁸ Johnston, R. B. and C. Pazarbasioglu. 1995. 'Linkages between financial variables, financial sector reform and economic growth and efficiency'. *IMF Working Papers*. WP/95/103. Washington DC

have a free and flexible entry and face no discrimination. This has resulted in foreign shareholding rising to almost half of the total assets⁵⁹.

Divestiture of public sector banks is also accompanied with financial liberalization. Regulations have been decreased to allow banks to make their own decisions as they seem fit. Key measures introduced include permission to open private banks, elimination of bank-by-bank credit ceilings, end to directed credit, removal of caps on lending rates etc⁶⁰.

Strengthening of regulatory/ supervisory framework

With all the privatization and liberalization, it was very important to have a strong regulatory and supervisory framework, otherwise situation could have rapidly deteriorated and Pakistan could experience banking crisis like Chile in 1980s. However, government took the right decision and augmented State Bank of Pakistan (SBP) capacity and powers and made it fully autonomous⁶¹. SBP has since approved and updated prudential and supervisory (PRS) framework. PRS aims to maintain financial stability while recognizing the need of being flexible. It encourages banks to operate in an efficient and transparent manner, while maintaining high standards of corporate governance. SBP has also augmented its surveillance and supervision capabilities and has taken strong action against banks which have faltered⁶². SBP regulatory standards are at par with BIS standards. Pakistan is largely compliant with 28 of the 30 Basel Core Principles.⁶³

Securities and Exchange Commission of Pakistan (SECP) has also raised its capabilities in view of new responsibilities. It has established a strong regulatory framework and has

⁵⁹ Daily Times. 2007. 'Foreign Banks to own 47% of banking assets by FY-end: SBP chief'. http://www.dailytimes.com.pk/default.asp?page=2007%5C04%5C05%5Cstory_5-4-2007_pg5_2

⁶⁰ IMF Pakistan Financial System Stability Assessment. 2004. <http://www.internationalmonetaryfund.com/external/pubs/ft/scr/2004/cr04215.pdf>

⁶¹ IMF Enhanced Structural Adjustment Facility <http://www.imf.org/external/NP/PFP/pakistan/INDEX.HTM>

⁶² Akhtar, S. 2007. 'Pakistan: Regulatory and Supervisory Framework'. Address to Institute of International Bankers, Washington DC. <http://www.sbp.org.pk/about/speech/governors/dr.shamshad/2007/Regulatory-Supervisory-Framework-19-Mar-07.pdf>

⁶³ Akhtar, S. 2006. 'Pakistan banking sector--- The need for second tier of reforms '. Address to the Pakistan Banking Association, London. <http://www.sbp.org.pk/about/speech/governors/dr.shamshad/2006/Banking-Sector-Reforms-23-Dec-06.pdf>

demonstrated its commitment to high regulatory standards by complying with the IOSCO principles⁶⁴.

Microfinance, SME and Islamic banks

SBP has realized that while its regulatory framework should be strong, it should be liberal in allowing different types of banks to function to cater to the needs of different sections of the society. Microfinance business is important for a country like Pakistan where almost one-third of the people live below poverty line. SBP has encouraged establishment of microfinance banks (currently six) but has also setup a special regulatory regime based on MFIs Ordinance, 2001⁶⁵. An SME bank has also been established.

While there is a moratorium on opening of new banks for quite sometime, SBP has allowed new Islamic banks to operate as it wants to reach people who prefer Islamic modes of financing⁶⁶.

Capital Market Development Reforms

GoP and SECP efforts have transformed the capital markets. Although, they cannot yet compete with markets in developed countries, it is clear that our capital market reforms have come a long way and that we are moving in the right direction. In the area of market development, major reforms introduced are as follows. Trading in future contracts have been introduced to provide basic hedging instruments and investment alternatives to the investors. National Clearing Company (clearing house) and Central Depository Company have been setup to promote efficiency in the market. Regulations governing Over-the-Counter (OTC) market were introduced and this market is also expanding due to the incentives provided to the companies⁶⁷.

To further deepen the market and to provide a complete range of products to investors, National Commodity Exchange Limited (NCEL) has been established to introduce trading

⁶⁴ SBP Banking System Review 2004

[http://www.sbp.org.pk/publications/bsr/bkg_system_review\(2004\).pdf](http://www.sbp.org.pk/publications/bsr/bkg_system_review(2004).pdf)

⁶⁵ SBP Governor Speeches.

<http://www.sbp.org.pk/about/speech/governors/dr.shamshad/2006/Development-Microfinance-13-Jun-06.pdf>

⁶⁶ Newsline <http://www.newsline.com.pk/NewsFeb2007/economyfeb2007.htm>

⁶⁷ SECP http://www.secp.gov.pk/corporatelaws/pdf/RegulationsGoverningOTCMarket_9_Mar_05.pdf

in derivatives, mainly futures contracts in commodities. NCEL is the first technology driven, de-mutualized, on-line commodity futures exchange in Pakistan⁶⁸.

Corporate Governance Reforms

Corporate governance is high on the international agenda after the debacles of ENRON and Worldcom. Pakistan has also introduced its own measures to improve corporate governance in the country.

- Banks: SBP has issued a Handbook for Corporate Governance for banks which defines the role, responsibilities and fit and proper criteria for CEOs, members of Board of Directors, key executives. It also talks about, among other things, restrictions on shareholdings and requirements of credit ratings
- Companies: Code of Corporate Governance was introduced in March 2002. SECP has made many amendments to the Companies Ordinance, 1984 to make implementing of code mandatory on all companies.
- Stock exchanges: Management has been made independent of brokers. Non-member directors have been appointed in the boards of directors of the stock exchanges and it has been binding that one of non-member directors will be chairman of the board.
- Institute of Corporate Governance has been established for undertaking research and training on corporate governance.

Risk management Reforms

Consistent efforts have been made to improve the risk management in our financial sector. Key reforms in capital markets include replacing of COT transactions with CFS, introduction of T+3 settlement system, universal identification number (UIN) and capital adequacy standards. Moreover, group accounts have been eliminated and brokers have been stopped from trading via other broker accounts. Finally, position limits for brokers have been defined in the ready, future and CFS markets.

In case of banks, there are standard limits on single and group exposures and clean lending. Moreover, SBP has notified that banks exposure on contingent liabilities cannot exceed ten

⁶⁸ NCEL <http://www.ncel.com.pk/>

times their equity. Banks are also asked to obtain CIB reports and audited balance sheets from certain borrowers. In the area of consumer financing, not only limits of exposure are defined but they are also asked to develop MIS reporting and their own risk management system for consumer financing.

Reforms in Insurance Sector

Insurance is a very important sector in the economy. It helps the economic and social development of a country by reducing uncertainty and by generating long-term financial resources. SECP has introduced major reforms in insurance sector. One of the most important steps was Insurance Ordinance which was promulgated in 2000 to provide a comprehensive regulatory framework for this sector⁶⁹. Insurance Rules were then notified in 2002 to expand on and clarify various sections of the Ordinance. Recently, stringent solvency standards have been introduced for life insurance companies and minimum paid up capital requirements have been increased from Rs. 150 million to Rs. 500 million and from Rs. 80 million to Rs. 250 million for non-life insurance companies. Moreover, insurance companies have been directed to obtain reinsurance treaties from the international “A” class re-insurers. To further develop the insurance market a new product Takaful insurance (i.e., insurance in accordance with Islamic Shariah) has been introduced and its rules notified⁷⁰.

Reforms in the Non-Banking Financial Sector

Non-Banking Financial Companies (NBFC) play an important role in mobilizing saving in Pakistan economy. This sector contains wide variety of companies, including leasing companies, real estate companies, discount houses, venture capital companies, security brokerage companies, mutual fund companies, insurance companies etc. In line with other reforms, SECP has also introduced risk management and corporate governance reforms in this sector. In 2003, SECP announced NBFC Rules under Companies Ordinance, 1984⁷¹. These rules have not only improved supervision of NBFCs but have also decreased the fragmentation found in this sector. There was a proliferation of institutions with low human

⁶⁹ SECP corporate laws http://www.secp.gov.pk/corporatelaws/aug_28_00.htm

⁷⁰ SBP Financial Sector Assessment, 2005

http://www.sbp.org.pk/publications/FSA/2005/Chapter_6.pdf

⁷¹ Daily Times http://www.dailytimes.com.pk/default.asp?page=story_2-4-2003_pg5_8

resource base, no access to technology, insufficient capital, and high cost of operations but now the sector is consolidating⁷².

Way Ahead

Pakistan has made lot of progress in the deepening of financial sector during the last decade and this may be one of reasons of high economic growth experienced in the last few years. However, there are still several areas of financial sector where Pakistan is not up to international standards. These reforms are, however, first generation reforms and although necessary, are not sufficient to bring long-term growth. To achieve economic growth, Pakistan will have to move to second generation reforms and further deepening and development of financial sector. Following are some of the actions which GoP, SBP and SECP plan to take during the next five years.

Strengthening the initiatives in SME, Agriculture and Microfinance

For financial deepening and increasing access, SBP plans to increase the agriculture credit. In SME sector, in collaboration with Small and Medium Enterprise Development Authority (SMEDA), rules will be made and capacity building of the bank staff will be built in program lending and supervision of this sector. Regime governing microfinance institutions will be further strengthened to increase its reach and stability.

New Financial Products in money/bond markets

Several new products are to be introduced to expand the reach of financial sector. These include infrastructure/municipal bonds which will open up long gestation infrastructure projects. SBP will also promote more mortgage loans and introduce mortgage backed securities.

Moreover, by introducing zero coupon yield curve through the bootstrapping process, bond stripping and development of GoP Bond Index, new financial products will be traded in money/bond markets⁷³.

⁷² SBP Report http://www.sbp.org.pk/publications/FSA-2003/Chapter_4.pdf

⁷³ SBP Strategic Plan 2005-10 http://www.sbp.org.pk/about/Strategic_Plan_BOD.pdf

Measures for strengthening Financial Sector

To introduce a safety net for the bank depositors, SBP is planning to introduce a deposit insurance scheme and increase the regulatory capital requirement further⁷⁴. Previous increase in regulatory capital requirement has already brought results. Standard Chartered Bank has bought Union Bank, ABN AMRO is in talks with Prime Bank and NIB Bank (a subsidiary of Singapore's state-owned investment company Temasek Holding) has asked for SBP permission for due diligence of PICIC⁷⁵.

Advances planned for Insurance Sector

Insurance sector in Pakistan is dominated by public sector and is still under developed even compared by standards of South Asian countries. To allow it to achieve its full potential, various reforms are in offing. These reforms include:

- Amendments in the Insurance Ordinance for more effective supervision and development of insurance sector;
- Privatization of one or more public sector insurers; and
- A comprehensive review of the solvency requirements for insurance companies⁷⁶.

Demutualization and Integration of Stock Exchanges

Demutualization is a process through which a member-owned company becomes shareholder-owned. Previously, it was the insurance companies, mostly mutually owned, which decided to demutualize and became more broadly owned. Now a lot of stock exchanges worldwide, like the London Stock Exchange (LSE), New York Stock Exchange (NYSE), Toronto Stock Exchange (TSE), have already demutualized or are planning to demutualize soon⁷⁷.

Proposal to demutualize and/or integrate the three stock exchanges of Pakistan is on the table for many years. There are many problems related to stock exchanges whose solution

⁷⁴ GoP <http://www.pakistan.gov.pk/divisions/economicaffairs-division/media/OMAR-AYUB-SECOND-GENERATION-REFORM.pdf>

⁷⁵ Daily Times report http://www.dailytimes.com.pk/default.asp?page=2006%5C12%5C07%5Cstory_7-12-2006_pg5_6

⁷⁶ SECP. http://www.secp.gov.pk/ChairmanSpeeches/PDF/2006/Nov_08_SeminarProgram.pdf

⁷⁷ http://searchsmb.techtarget.com/sDefinition/0,,sid44_gci763564,00.html

seems to be demutualization and/or integration of three exchanges. These problems include narrow base of investors, weak professional management & ineffective regulation of members, fragmentation of market, lack of transparency, insufficient economic and human capital and high degree of speculation. SECP is presently considering this proposal⁷⁸.

Improving the efficiency, stability and transparency in capital markets

Stock exchange crashes in March 2005 and then again in 2006 has caused concern. There is lot of talk about the involvement of some brokerage houses in these crashes. To avoid such happenings in future and to increase the efficiency, stability and transparency of markets, SECP plans to introduce the new capital adequacy regime and early warning reserve. Moreover, there will be restrictions on netting across clients, markets and settlement periods. Finally, new margin system set on value at risk basis will be introduced and mark-to-market loss collection and profit distribution system will be implemented.

Regulatory Impact Assessment

Regulatory impact assessments (RIAs) are done all over the world to answer questions like whether regulations are achieving their objectives and what are the costs of regulatory compliance. This helps in deciding whether regulations should be continued, modified or discarded. This is relatively new concept in Pakistan. SECP plans to do RIAs in various areas of its supervision to improve its work⁷⁹.

Improving access to financial services

Finally, it is important that as new financial services and products are introduced, the access to these services is not limited to a specific group of people. New developments and technologies like e-commerce and e-banking can help in this regard. As number of mobile phones increase, m-banking can also be used to bring financial services within the reach of more people. SBP and SECP plan to encourage adoption of these new technologies in future⁸⁰.

⁷⁸ Lahore Stock Exchange. 2004. 'Report of expert committee on demutualization and integration/transformation'. http://www.lahorestock.com/Rpt_Demutualization_Integration.pdf

⁷⁹ SECP <http://www.secp.gov.pk/ChairmanMessage.htm>

⁸⁰ The News http://www.thenews.com.pk/daily_detail.asp?id=28485

Useful Resources

1. State Bank of Pakistan www.sbp.org.pk
2. Lahore Stock Exchange. <http://www.lahorestock.com/>
3. Security and Exchange Commission of Pakistan www.secp.gov.pk
4. NCEL <http://www.ncel.com.pk/>
5. IMF Pakistan Financial System Stability Assessment. 2004.
<http://www.internationalmonetaryfund.com/external/pubs/ft/scr/2004/cr04215.pdf>
6. Financial Deepening Challenge Fund
<http://www.financialdeepening.org/default.asp?id=700&ver=1>
7. Karachi Stock Exchange www.kse.com.pk
8. Islamabad Stock Exchange www.ise.com.pk
9. IMF Working Papers <http://www.imf.org/external/pubind.htm>
10. Asian Development Bank www.adb.org
11. World Bank www.worldbank.org
12. Ministry of Finance www.finance.gov.pk

Session V: Industrial Growth: Moving up the Competitiveness Curve – Background Brief⁸¹

National Competitiveness and Industrial Growth: Introduction

A country's prosperity depends on its competitiveness in the world economy. Despite being endowed with vast natural resources and world's sixth largest population, Pakistan doesn't fare well in terms of competitiveness. Two of the world's most prestigious competitiveness indices rank Pakistan well below countries like China and India. Pakistan is ranked 66th on the Business Competitiveness Index (BCI) of the World Economic Forum and 91st on the Global Competitiveness Index (GCI) in the 2006 Global Competitiveness Report.

Definitions of Competitiveness

1. The ability of a nation or firm to sell competitive goods or services in international trade. **Institute for Trade and Commercial Diplomacy**⁸²
2. The degree to which a nation can, under free trade and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining and expanding the real income of its citizens. Canadian **Business in the New Stakeholder Economy**⁸³
3. Competitiveness is fundamentally determined by the productivity of an economy, the ability of firms and subsidiaries based in a country to get efficient output per dollar of capital per unit of labor. Professor **Michael Porter**, Professor at Harvard University's Institute for Strategy and Competitiveness
4. Competitiveness for firms is the ability to succeed against competitors in ways that lead to higher profits. On the macroeconomic level, competitiveness is the ability of a nation to support productivity allows a high and rising standard of living. This usually involves competitiveness in a sufficient range of firms and industries to foster economic growth and development. Professor **Michael Enright**, Director of the Competitiveness Program at the Hong Kong Institute of Economic and Business Strategy⁸⁴

⁸¹ **Disclaimer:** This Background Brief has been prepared by Raja M. Ali Saleem for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

⁸² Institute for Trade and Commercial Diplomacy website www.itcdonline.com/introduction/glossary2_abcd.html

⁸³ Canadian Business in the New Stakeholder Economy website www.ucs.mun.ca/~rsxty/business1000/glossary/C.htm

⁸⁴ Competitiveness Support Fund <http://www.competitiveness.org.pk/whatiscomp.php>

The link of industrial development and competitiveness is long recognized. Looking at BCI and GCI, one clearly sees that the countries which are on top in these indices are also the most industrially developed⁸⁵. Developing countries, like Pakistan, depend on technology transfers from developed countries and can, therefore, never compete with them in international markets. Pakistan has been among the fastest growing economies in Asia in the last few years. But this thrust can only be sustained, if we become more competitive and for that we need to advance ourselves industrially.

Background and Policy Framework

Industrial sector has long been focus of Government of Pakistan (GoP) planning. Pakistan's first five year plan in the fifties called for rapid industrialization and our current Medium Term Development Framework (2005-10) also tries to achieve the same objective⁸⁶. During all these years, we have achieved some landmarks but relative to even countries in our own region, we haven't progressed much. What has been missing is a coherent approach to issues which inhibit industrialization and decrease competitiveness.

Recently, GoP decided to address the industrialization issues in a comprehensive way and have come up with a draft industrial strategy⁸⁷. Some of the important recommendations of this strategy are as follows:

I. Streamlining and Modernizing Regulation governing factor markets and strengthening of Contract Enforcement

Regulation can be restrictive leading to low investment or it can be sensible and easy to comply with, thus helping investors, ensuring a level playing field and improving the functioning of capital, land and labor markets. Pakistan has to find a balance between too much regulation and a laissez-faire policy, both of which are equally dangerous.

⁸⁵ Business Competitiveness Index http://www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/GCR_05_06/Business_%20Competitiveness_Index.pdf

⁸⁶ MTDF, Planning Commission <http://www.pakistan.gov.pk/ministries/planninganddevelopment-ministry/mtdf.htm>

⁸⁷ Industrial Strategy <http://www.engineeringpakistan.com/IB/MainReport.pdf>

Another area which is critical to economic growth is the enforcement of contracts. In Pakistan, contracts are hard to enforce which add additional risks to investors. These costs have to be reduced to make it easier for everyone to invest and promote industrialization.

II. Reducing the Burden of Taxation

Burden of taxation in Pakistan is disproportionate. Very few people pay taxes, leaving percentage of taxes to GDP very low. This has to change by broadening the tax base so that high tax rates are lowered without decreasing tax collection. In case of custom duties, although, GoP has reduced the number of tariff bands and the rate on its highest tariff band has been cut to 25 percent, there is still a need of reducing tariff dispersion and closing loopholes.

Rules and procedures that govern income tax are complex after five year of reforms and the rate of income tax is still high. Tax structure should be streamlined and simplified and tax rates should be reduced to benefit investors.

III. Removing Infrastructure Bottlenecks

There are three areas where Pakistan has to act

- **Securing energy needs:** Increasing cost of electricity and its constant disruption is adding to our industrialist's cost and making them uncompetitive in the world markets. Pakistan has to act swiftly, if it wants to increase its exports.
- **Efficient transportation:** Roads and railway network leaves lot to be desired. There is an urgent need of increasing roads and railway track to all parts of country. Moreover, poor quality service and delays have to be eliminated to decrease these mostly hidden costs
- **Industrial Parks:** Basic services like power, sanitation, financing and drainage are essential for industries to grow. Government should setup industrial parks to provide these services at one place so that industrialists can devote all their energies to improving their products and increasing their profits.

IV. Upgrading Worker Skills

Upgrading workforce is another area where Pakistan has to do lot of work. Productivity is linked with education and skills training as it help adoption of new technologies As most of the Pakistani workers are illiterate and quality of education imparted is generally low, it is easy to understand why foreign investment in Pakistan has been low.

V. Towards Vibrant Small and Medium Enterprises

SMEs are a vital part of any economy. They promote innovation and generate employment. Experience of developed countries shows that unless SMEs flourish, economy cannot develop. Government should work more to create an enabling environment for SMEs.

VI. Provincial Strategies to Lower Location Specific Costs and New Vents for Industrial Growth

Although the major burden of promoting industrialization is with the federal government, each province should work to enhance its own endowments. For example, Balochistan should give more importance to mining, petroleum exploration and fruit export industries while NWFP can concentrate on tourism, hydropower development and livestock industries.

Government of Pakistan Initiatives

Working on this strategy, GoP has taken several initiatives

I. Focus on Engineering Sector (Restructuring of PIDC and EDB)

Pakistan Industrial Development Corporation (PIDC) was established in 1952 to facilitate the industrialization of the country. Over the years, it did a commendable job but lately it was felt that this corporation would not fit in with the rapidly changing world. Therefore, it was decided to restructure it making it compliant with the issues of the new century. First, it was incorporated as a company. Then, a restructuring plan was also implemented to revitalize it. Currently, PIDC is not only led by a private sector professional but most of the members of its board of directors are also from private sector⁸⁸. PIDC has taken new initiatives since its restructuring. It has created six new companies to support developments of specific sector. These companies are independent of government rules and regulations

⁸⁸ The Nation. <http://www.nation.com.pk/daily/nov-2004/19/business.php>

and can take their decisions according to market requirements. PIDC finances and monitors these companies. The names of the companies are as follows

- Technological Up gradation and Skill Development Company;
- Pakistan Gem and Jewelry Company;
- Pakistan Industrial Parks Development and Management Company;
- Karachi Tools, Dies and Moulds Centre
- Policy Stone Development Company
- Pakistan Hunting and Sporting Arms Company

Expert Advisory Cell (EAC) was established in 1979 as techno-economic arm of the then Ministry of Production. It used to do performance monitoring and evaluation of public sector corporations. Its role gradually diminished due to the privatization of private sector corporations. Engineering Development Board (EDB) was created in 1995 as an autonomous body. Its mandate was policy formulation and facilitation of engineering industry. The present government decided to merge EAC into EDB and restructure EDB to perform a broader role. The redefined mission of EDB is (a) to give impetus to the development of engineering sector to lead as a driving force for economic growth and (b) to make engineering sector part of global supply chain⁸⁹.

Some of the new initiatives of EDB are given below:

- Tariff based system to replace deletion programme with WTO's TRIM compliant system
- Registration/Revision of locally manufactured goods
- Tariff proposals for each year budget
- Revamping of entire ginning sector machines
- Engineering Goods export strategy
- New Auto Policy
- Modernization of trucking sector
- Location specific initiatives

⁸⁹ Engineering Development Board <http://www.engineeringpakistan.com/EngPak1/index.php>

Development of SME sector

Government of Pakistan has taken several initiatives to promote the SME sector. These include establishment of restructuring and expansion of SMEDA and establishment of SME bank. There have been increased efforts to bring various ministries and provincial governments together to come up with an agreed agenda. This resulted in the first SME policy last year⁹⁰.

Several strategy working groups (SWOGs) are also working to enhance SME in specific sectors. Major SWOGs are working in the following areas:

- Gem jewellery;
- Marble/Granite;
- Dairy;
- Surgical instruments;
- Fans, Sports goods and fisheries in process⁹¹

III. National Industrial Parks

As recommended in the industrial strategy, a National Industrial Parks development and management company (NIPDMC) has been established under PIDC. Its revolving Rs 2 billion fund would be used to develop industrial estates. This company has so far worked on the following projects.

- Industrial park in Pak Steel Downstream Industrial area (1500 acres)
- Korangi Industrial Park, Karachi (250 acres)
- Bin Qasim Industrial Park
- Marble City at Risalpur
- Marble City at Mohmand Agency

⁹⁰ SME policy <http://www.smepolicy.net.pk/smepolicy2006.html>

⁹¹ SMEDA website www.smeda.org.pk

NIPDMC is contemplating to develop industrial parks in Jhang, Rahim Yar Khan, Bahawalpur and Peshawar⁹².

IV. National Energy Conservation Policy, 2005

Energy costs are a large proportion of total product costs in Pakistan. Industrialists in Pakistan frequently mention high energy costs as the main reason of low competitiveness of Pakistani products. Although, GoP is working for lowering energy costs by commissioning new hydropower projects and by importing gas from Iran/Qatar, until a few year back no attention was paid to energy conservation techniques which not only lower energy costs but also help save the environment. In 2005, GoP came up for the first time with its 'National Energy Conservation Policy'⁹³. This policy not only provides guidelines for energy conservation in various sectors but also provide the legal/regulatory framework for someone who is new to this sector.

Donor Funded Initiatives

I. Competitiveness Support Fund (CSF)

Competitiveness Support Fund (CSF) was established, with the help of USAID, in May last year. Although, different ministries were looking at different aspect of competitiveness, it was felt that unless a body looks at Pakistan's competitiveness as a whole, progress would be minimal. The main functions which CSF will perform are as follows:

- Assist in the development of innovation systems;
- Improve the regulatory framework for competitiveness;
- Help start-ups that have completed the business incubation process;
- Commercialise the result(s) of research (start-ups);
- Pilot projects identified as part of better strategy; and

⁹² The NEWS <http://www.jang.com.pk/thenews/jan2006-daily/03-01-2006/business/b4.htm>

⁹³ National Energy Conservation Policy http://www.pakistan.gov.pk/divisions/environment-division/media/National_Energy_Conservation_Policy.pdf

- Promote competitive economic sectors which have potential for increasing a sector's domestic market and export.

Since its inception, CSF has signed MOU with a number of public and private sector agencies to improve competitiveness. These agencies include Government of Sindh, Higher Education Commission, Pakistan Agriculture Research Council etc. But by far the biggest achievement of CSF, is the publication of 'The State of Pakistan's Competitiveness Report 2007'. This report delves deep into the reasons of low level of innovation and competitiveness in Pakistan and suggests several measures to enhance competitiveness of Pakistani products in international markets⁹⁴.

II. Infrastructure Project Development Facility (IPDF)

Public private partnership (PPP) model has been a success internationally as it combines the best features of public and private sectors. A task force was established last year, with the help of ADB, to look into the benefits of introducing PPP model in Pakistan. A conference 'PPP 2006 Forum' was held under this taskforce which was attended by international and national experts. The report of this conference was recently published⁹⁵. Infrastructure Project Development Facility (IPDF) was also established last year to provide institutional support to the PPP task force⁹⁶. It is an independent company established, with the help of USAID, under Companies Ordinance, 1984. It's main functions are:

- Serve as the PPP task force secretariat;
- Provide technical assistance to the implementing agencies regarding PPP contracts;
- Increase/build implementation capacity of partner institutions;
- Arrange/ Provide inputs on the needs of Government's support such as availability of guarantees, subsidies, long term fixed rate local currency financing, etc.

Challenges and Way ahead

Pakistan has to move to an advanced level of competitiveness, if it wants to decrease poverty and join the rank of middle income countries but the road to El Dorado is not easy. As stated in 'State of Pakistan's Competitiveness, 2007' and 'Toward a Prosperous Pakistan: A

⁹⁴ Competitiveness Support Fund website www.competitiveness.org.pk

⁹⁵ 2006 PPP Forum Report <http://www.ipdf.gov.pk/final%20ppp%20Report.pdf>

⁹⁶ Infrastructure Development Project Facility website <http://www.ipdf.gov.pk/>

strategy for Rapid Industrial Growth', Pakistan needs macroeconomic stability, efficient factor markets, effective regulation, skilled workforce endowed with spirit of entrepreneurship, centres/universities doing cutting edge research, reduced banking and country risk, low-cost energy and strong infrastructure. The present government is working on all these fronts. In some areas, like macroeconomic stability, we see lots of progress but in other areas, like efficient factor markets and universities doing advanced level research, future looks a lot like the present. What GoP needs to do is to press ahead, with the help of donor community. There are many difficulties ahead but as many countries have shown us, these difficulties are not insurmountable.

Useful Resources

1. Ministry of Finance website www.finance.gov.pk
2. Ministry of Industries, Production and Special Initiatives website www.moip.gov.pk
3. UNIDO, Pakistan www.un.org.pk/unido/

4. Harvard Business School, Institute for Strategy and Competitiveness
<http://www.isc.hbs.edu/>
5. Hong Kong Institute of Economic and Business Strategy <http://www.hiebs.hku.hk/>
6. The Competitiveness Institute <http://www.competitiveness.org/>
7. Global Competitiveness Report
<http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>
8. Ministry of Environment website
<http://www.pakistan.gov.pk/ministries/index.jsp?MinID=5&cPath=42>
9. SMEDA website www.smeda.org.pk
10. SME policy website www.smepolicy.net.pk
11. Pakistan Environmental Protection Agency <http://www.environment.gov.pk/>
12. Business Competitiveness Index
http://www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/GCR_05_06/Business_%20Competitiveness_Index.pdf
13. Engineering Development Board
<http://www.engineeringpakistan.com/EngPak1/index.php>
14. Competitiveness Support Fund website www.competitiveness.org.pk
15. Malaysian Industrial Development Authority www.mida.gov.my
16. Infrastructure Development Project Facility website <http://www.ipdf.gov.pk/>
17. Department of Industrial Development, India <http://did.nic.in/>
18. National Industrial Park Management and Development Company website
19. USAID Pakistan website <http://www.usaid.gov/pk/>
20. MIT Center for Technology, Policy, and Industrial Development
<http://web.mit.edu/ctpid/www/>

FATA Development Forum – Background Brief⁹⁷

⁹⁷ **Disclaimer:** This Background Brief has been prepared by Dr Iffat Idris for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

Pakistan's Federally Administered Tribal Areas (and other border areas) occupy a unique position in Pakistan. They have historically enjoyed considerable autonomy. However, this autonomy has created opportunities for militant and extremist activity, both by locals and foreigners. At the same time, people in the FATA belt have been left far behind the rest of Pakistan in terms of services, infrastructure and development. In the wake of 9/11, there is strong recognition that the FATA belt needs to be brought into the mainstream, law and order issues have to be addressed, and in particular, development has to be promoted.

This Brief gives an introduction to the FATA belt and its unique history. It explains the situation there in terms of governance arrangements, the challenges of militant activity, and of poor development. The Brief ends by outlining the Government's initiatives to promote sustainable development in the region, and those of some of Pakistan's development partners.

1. Introduction to FATA

The Federally Administered Tribal Areas (FATA) form a belt in the North-West of Pakistan. FATA is bordered, going clockwise from north, by districts of NWFP, Dera Ghazi Khan, Balochistan and Afghanistan to the west. At its longest, FATA stretches for 450 km, and is 250 km across at its widest point. The total estimated area of the FATA belt is 27,220 sq. km. Much of this is extremely rugged mountainous terrain.

FATA comprises seven political agencies: Bajaur, Khyber, Kurram, Mohmand, North Waziristan, Orakzai and South Waziristan. It also has six smaller zones, referred to as 'frontier regions' (FRs) in the NWFP districts of Bannu, Dera Ismail Khan, Kohat, Lakki Marwat, Peshawar and Tank.

According to the 1998 Census, the population of the FATA belt was 3.18 million. Of these only 3.1% lived in established townships, making FATA the most rural administrative unit in Pakistan. The average annual population growth rate for the period 1981-98 was 2.2%, slightly lower than the national average. Tribal culture predominates FATA society.

There are also Provincially Administered Tribal Areas, which fall under the administrative control of the NWFP/Balochistan Governments. PATA comprise the districts of Chitral, Dir and Swat, Malakand Protected Area, the Tribal Area adjoining Mansehra, the former State of Amb, the districts of Zhob and Loralai, and parts of Chagai and Sibi districts. Both FATA and PATA are recognized in Article 246 of the Constitution.

2. Historical Background

The FATA belt has always been of great strategic importance. Under British rule, it formed a buffer between India and Russia. The British made several attempts to 'conquer' the area and run it directly. But fierce resistance from the independent tribal population forced them to take a different approach. Tribes were provided financial incentives to cooperate with the British and protect their interests. However, the arrangement did not always run smoothly.

Repeated problems with tribal raids and other such incidents led the British to impose the Frontier Crimes Regulations.

The FCR were distinct from the civil and criminal laws in force throughout the rest of British India. Based on the principle of collective responsibility, the FCR provided for collective punishments in the tribal areas, and for dispute resolution through *jirgas* (tribal councils). A revised FCR was issued in 1901 which expanded the scope of the earlier regulations and gave wider powers, including judicial authority, to administrative officials. The British exercised authority through appointed political agents who, alongside their wide powers, were given substantial funds to buy influence and cooperation. Local chiefs were 'recruited' to act as intermediaries between the colonial administrators and the tribes, and to ensure that Government policies were respected. The political agents and partner tribal leaders were solely concerned with promoting British interests; they did not interfere in the day-to-day running of the area. Even then, the system was never wholly successful and British grip remained tenuous.

Following the end of colonial rule and the creation of Pakistan in 1947, the various tribes in the region entered into agreements with the Government of Pakistan, pledging allegiance to the new state. Some 30 Instruments of Accession were signed but these retained the autonomy of the local tribes. Except where strategic considerations dictated, the tribal areas were allowed to run affairs according to their tribal customs and norms. This arrangement was given legal cover in the country's constitutions. The 1973 Constitution provides for the exercise of executive authority by the federal government over FATA (and by the provincial government over PATA) but stipulates that, unless directed by the President, no Act of Parliament would apply to FATA and neither the Supreme Court nor High Courts will exercise any jurisdiction in relation to FATA.

From 1947 until 2001 there was very little change in the relationship between the federal government and FATA. The area continued to be administered by political agents, who worked for the wider interests of Pakistan but did not get involved in day-to-day affairs. The extent of tribal autonomy can be gauged from the fact that no Pakistan Army soldier set foot in FATA during this period. The Soviet invasion of Afghanistan and the subsequent struggle by the Mujahideen to oust the Soviets made FATA a frontline area in that war. Numerous local as well as foreign fighters converged on the region. It also became a hub of arms and drug trafficking. Following the withdrawal of Soviet troops from Afghanistan, many of these militarized elements remained in FATA.

3. Administrative Arrangements

Administrative arrangements for FATA have undergone some changes in recent years, but otherwise remain essentially what they were under British rule and post-independence Pakistani governments:

- Administration - FATA is administered by the NWFP Governor in his capacity as agent of the President of Pakistan. Each agency is administered by a Political Agent, supported by Assistant political agents, *tehsildars*, *naib tehsildars* and a range of security services: the *khassadar* (local police), Scouts and Levies. In the Frontier Regions, the same role is exercised by the District Coordination Officer. FATA is divided into ‘protected areas’ which are controlled directly by political agents, and ‘non-protected areas’ which are controlled through local tribal chiefs.
- Autonomy and Political Representation - Laws passed in the National Assembly are not applicable to FATA, except under special order from the President. FATA is represented in the National Assembly and the Senate, but not in any Provincial Assembly.
- Delivery of Services - In the federal government, matters related to FATA are dealt with by the Ministry of States and Frontier Regions. Until 2002 development activities were coordinated by the NWFP Planning and Development Department and implemented by government line departments. In that year a separate FATA secretariat was set up, which in 2006 became the FATA Civil Secretariat. It is headed by an Additional Chief Secretary and has several senior officials. The Secretariat is responsible for decision-making about development activities: implementation is carried out by the Secretariat’s own line departments. The Political Agent has a supervisory role in development projects. Decentralization of power and establishment of local governments under the LGO 2001 does not extend to FATA.
- Funding - FATA receives a share of the Annual Development Programme of the federal government. It also gets separate funding for special programmes and projects under the Public Sector Development Programme. Each FATA Senator and MNA receives funds under the Khushal Pakistan Programme to spend on local development. Some donor agencies are funding programmes in the region. Current expenditure for salaries and other costs of the FATA Secretariat and line departments are supposed to be provided separately, but in practice development funds often get utilized on these.
- Law and Justice - The Frontier Crimes Regulations 1901, based on the concept of collective responsibility and collective punishment and providing for dispute resolution by *jirgas*, is still the prime law governing the FATA region: all civil and criminal cases in FATA are dealt with under the FCR. However, residents can challenge FCR rulings in the High Courts or Supreme Court. Actual application of the FCR is different in ‘protected’ and ‘non-protected’ areas. In protected areas the political agent has a key role in the referral of cases to a *jirga* and performs a ‘regulatory function’ in its rulings. In non-protected areas cases are dealt with directly by *jirgas* with no oversight by political officers.

4. Challenges Facing FATA: Law and Order

In the wake of the 9/11 attacks and the 'war on terror' launched by the United States against Al-Qaeda and the Taliban in Afghanistan, Pakistan's north-west tribal belt and particularly FATA, has been in the international spotlight. The autonomy enjoyed by FATA, the region's proximity to Afghanistan, the mountainous terrain and isolation, and the conservative outlook of the population are all factors leading analysts to believe that Al-Qaeda and Taliban leaders and activists are being sheltered in FATA. Washington's determination to catch Osama bin Laden and other militants has led to considerable pressure being applied on the Pakistan Government to launch military offensives in FATA.

In March 2004 the Pakistan Army entered FATA for the first time in the country's independent history, with a military operation in Wana, South Waziristan. Fighting led to many casualties on both sides and in April a deal was brokered whereby local militants would be granted amnesty if they agreed to live peacefully and if all foreigners living in the region registered with the authorities. However this deal collapsed soon after and Nek Mohammed, the key local militant involved in it, was later killed.

Since then tension has remained high in the FATA belt, though the intensity of conflict has fluctuated. The location has also changed: while South Waziristan was initially the focus of militant and military activity, increasingly clashes have been taking place in North Waziristan and, most recently, Bajaur and Kurram Agencies. Local resentment is fuelled by anger at the perceived 'intrusion' by the Pakistan Army, sympathy for Islamic militants, and the application of FCR collective punishments against communities harbouring militants or engaged in militant attacks. These punishments have taken the form of economic blockades as well as demolition of houses and other property belonging to suspected militants/those sheltering them.

With the re-emergence of the Taliban in southern Afghanistan, many fingers are still being pointed to FATA – seen as enabling them to regroup and regain their strength, as well as to carry out cross-border attacks in Afghanistan. Washington retains the strong belief that Osama bin Laden and other senior Al Qaeda fugitives are hiding in the region. Hence the pressure on Pakistan to continue military offensives in FATA persists.

However, in September 2006 a grand *jirga* was convened in North Waziristan and the Government and tribal leaders reached an agreement designed to reduce conflict. Under the terms of the Miramshah Accord, militants agreed not to launch any attacks on law-enforcement personnel and government property or to conduct cross-border attacks, while the Government agreed to stop ground and air operations against militants. Critics have condemned the September agreement as appeasing the militants and giving them a green light to carry out further attacks. From the Government perspective, it is a means to achieve its ultimate goal of ending militant activity with minimal loss of life and disruption to civilian populations.

It should be stressed that, as well as the on-going 'war on terror' being waged in FATA, there are underlying problems of law and order. Tribal and clan conflicts are common; criminality is on the rise; smuggling is one of the main sources of revenue in the region. The traditional systems of justice – the *jirgas* – are increasingly proving incapable to dealing with the situation. There is growing evidence that they have become 'corrupted' and favour the

rich and powerful in their rulings. For ordinary people, in particular, it is extremely hard to get justice.

5. Challenges Facing FATA: Development⁹⁸

The extreme isolation and autonomy of FATA has had a very detrimental impact on the region's development. FATA is among the most economically backward areas in Pakistan. Less than 10% of the land is cultivable, meaning agriculture is simply enough for subsistence. There are hardly any industries in the region and few jobs. The main source of revenue is actually smuggling, arms and drug trafficking. Per capita income is under \$250, well below the national average.

The lack of economic prosperity is reflected in the area's very poor human development indicators. Some 60% of the population live below the poverty line. Education levels are very low: there are few schools, enrollment is low, drop-out rates high. The overall literacy rate is 17.42%, much lower than the average 56% literacy rate in the rest of the country. The gender disparity in education is also much greater: male literacy in FATA is 29%, female just 3%. This figure indicates the strong discrimination faced by women in FATA: a combination of religious and tribal traditions keeps them suppressed.

There are very few health facilities serving the 3 million plus population: FATA has just 41 hospitals and 1 doctor for every 6,762 inhabitants [the national average is 1:1,359]. Women are particularly badly off because of the lack of female health staff – socio-cultural taboos mean they cannot be seen by male staff. Infant mortality rates are estimated at 87 deaths per 1,000, maternal mortality at a staggering 600 deaths per 100,000 live births. The same conservative thinking leads to NGOs and others trying to bring modern education and health care to FATA to be viewed with suspicion.

FATA's remote location and remote habitations – 97% of the population is rural – makes effective service delivery difficult. There are insufficient resources and staff to provide facilities for all residents within easy access. Facilities are far apart. The very poor road system makes access to these extremely difficult. Even for those who are able to access them, the quality of service provided is generally poor. School buildings are often used for other purposes. Schools lack furniture and equipment; staff absenteeism is common. Medicines are widely available but tend to be counterfeit or sub-standard. Few inhabitants have access to clean drinking water, and fewer still to sanitation facilities. Electricity connections are limited and supply is hampered by frequent power cuts, low voltage and breakdowns. Heating and cooking is done almost entirely with wood – causing rapid depletion of forest resources in FATA.

Past development initiatives have tended to focus on infrastructure rather than the equally important development of human resources needed to make facilities fully functional. Furthermore, the effectiveness of resource allocations for FATA has been eroded by corruption, poor planning, political interference and protection of vested interests, adhocism, lack of coordination between different service providers, lack of capacity among line department staff, and lack of transparency and accountability. The poor law and order

⁹⁸ All figures taken from *FATA Sustainable Development Plan 2006-2015* (Government of Pakistan, 2006).

situation makes it difficult for service providers – government and private – to operate; many areas are totally inaccessible. It also creates a climate of fear which discourages people from working in FATA. A further major issue in planning and implementing development projects in FATA is the lack of reliable baseline data which would identify priority sectors and geographic areas for interventions.

6. Impetus for Change

Two predominant conclusions emerge about FATA from the above analysis:

- a) the region's autonomy has contributed to the lack of law and order, and to the on-going militant activity and conflict in FATA;
- b) FATA's autonomy has had a very detrimental impact on economic growth and development, and today the region lags far behind the rest of Pakistan.

The situation in FATA is no longer tenable for multiple reasons:

- More than sixty years after independence, the writ of the state should extend to all parts of the state. The notion that FATA is immune from laws applicable to the rest of the country, and that Pakistan armed forces cannot operate in FATA negates the region's inclusion as part of Pakistan. In other words, if FATA is part of Pakistan it should be treated as such.
- In practice, autonomy means the denial of many of the rights enjoyed by the rest of the country's population to the people of FATA. The concept of collective punishment, for example, and the lack of access to an independent judicial system represent significant violations of human rights.
- The people of FATA have a right, and pressing need, for access to quality health and education services, clean drinking water, sanitation facilities and other services. The dire human development indicators in the region have to be improved.
- The on-going conflict in FATA is taking its toll both on civilian populations in the region and Pakistani armed forces, and presents a serious threat to national security and stability.
- The international community is no longer prepared to tolerate the existence of an autonomous tribal belt in which militants (Al-Qaeda, Taliban and the like) can shelter and flourish. It has a very negative impact on Pakistan's image globally.

While military operations and increased security measures can curb the militant problem to some extent, the real solution lies in addressing the underlying causes of militancy and extremism. The fact that there is a strong correlation between lack of development and militancy – seen not just in FATA but in many other developing countries – highlights the way forward. If the problems of FATA are to be addressed the following are necessary:

- An end to the special autonomy enjoyed by FATA and to discriminatory legislation, notably the FCR.
- Integration of FATA with the rest of the country, both constitutionally and physically through the expansion of road networks and communication.
- Promotion of democracy in FATA and empowerment of ordinary people.
- Provision of quality services to the people of FATA so human development indicators improve.
- Creation of opportunities for employment generation and economic growth.

7. Government Initiatives: FATA Sustainable Development Plan

There is strong recognition in the Government of Pakistan that the situation and status of FATA has to be reformed.

In May 2005 the Governor of NWFP formed a FCR Reform Committee. Headed by a retired Chief Justice of the Peshawar High Court, with former officials and journalists among its members, the Committee examined changes to be made to the FCR. Extensive consultations were carried out in FATA, after which the Committee submitted its recommendations to the Governor. These have not been made public but sources say they include modifications to the FCR, e.g. in the collective responsibility clauses, but do not call for its total abolition.

The Government has taken some steps to promote political participation and democratization in FATA. In December 2004 the NWFP Governor issued a notice to establish 'provisional agency councils to facilitate local participation in development and other important matters'. The councils are elected for a three-year tenure on the basis of population, but 30% are reserved for tribal leaders, religious scholars, technocrats, women and minorities. The first council elections were conducted, somewhat controversially, in December 2005.

Increased security measures, FCR reform and democratization are important elements of the Government's strategy for FATA, but by far the main component is promoting development in the region. Funding allocations to FATA have increased steadily over the past five years, rising from less than Rs.1 billion in 2001 to Rs.1.18 billion the following year, and Rs.6.2 billion in 2005-6. The Government's future plans for FATA entail investment on a much bigger scale.

The FATA Sustainable Development Plan (SDP) has been prepared by the Government to address the development challenges facing FATA. The SDP takes an integrated approach to combine economic and social development with environmental integrity and poverty alleviation. It is focused on the people of the region, and aims to:

- Address basic needs of FATA residents;
- Improve institutional and financial capacities to promote development;
- Explore diverse opportunities for economic growth and employment generation;
- Maintain ecological and subsistence-support systems for ordinary people;
- Monitor and evaluate multi-sectoral progress to support and strengthen sustainable development.

The SDP is designed to be different from previous (failed) development initiatives in FATA. Its preparation entailed extensive literature reviews, analyses of various development sectors, consultations with FATA Secretariat, NWFP Government and other relevant officials, field visits and, crucially, a series of public consultations with the people of FATA. The outcome of this rigorous process is the SDP.

The SDP outlines a number of over-arching issues facing FATA – governance, law and order, society and culture, services and utilities, economy and development, and environment - and lays out over-arching strategies to address these. The strategic objectives form the basis for specific interventions in each sector. In ‘economy and development’, for example, the SDP identifies lack of infrastructure (especially roads), lack of skills, lack of opportunities for employment and entrepreneurial activity, and lack of a regulatory framework for private investment as key constraints. To overcome these it proposes massive public sector investment to promote economic development, local skills development, and provision of a regulatory framework for investment.

Once approved by the NWFP Governor, all future development projects and activities in FATA will have to conform to the over-arching strategies presented in the SDP. Primary responsibility for implementation of the SDP rests with the FATA Civil Secretariat and its line departments. They are tasked with the planning, execution, regulation and coordination of all development activities. The private sector is envisaged to play a major role as well, facilitated by the establishment of a more conducive framework for investment. Public-private partnerships will be promoted by the FATA Development Agency (FDA), set up in October 2006. The third implementation partner is civil society, whose participation is vital to ensure development interventions are geared towards meeting the needs of people on the ground. There are plans to establish a FATA rural support programme.

The SDP is expected to be implemented over a nine-year period, divided into a five-year intervention phase followed by a four-year consolidation phase. The total funding requirement for full implementation is estimated at Rs.124.1 billion, of which the greater portion will be used in the intervention phase (when facilities and infrastructure are built). Of this total, approx. Rs.63.6 billion is already committed, Rs.60 billion by the Government and Rs.3.6 billion by foreign donors. The unfunded portfolio will be offered to donors for grant and loan funding.

8. Initiatives by Pakistan’s Development Partners

As seen, FATA has attracted considerable international attention and concern. This has led to several development partners funding programs for development in FATA. Notable among these are those by the US Agency for International Development (USAID) and Asian Development Bank (ADB).

Activities being undertaken by USAID in FATA include:

- Increasing school enrollment by constructing and furnishing 65 primary, middle and high schools in five Agencies, and partnering the Government of Japan in building a further 65 schools.
- Increasing teacher numbers by providing scholarships to 40 females from FATA to undergo one-year training in Khyber Agency.
- Improving child health care services through training of care providers, improvement of facility-based and community-based care, and advocacy about child health care in communities.

- Improving water and sanitation facilities in 190 girls' schools in two Agencies; raising community awareness of hygiene and sanitation; and partnering the Government's Clean Drinking Water Initiative in three Agencies.
- Supporting implementation of polio immunization campaigns and monitoring by UNICEF and WHO.
- Supporting the expansion of the Khushali Bank into FATA, entailing the establishment of branches in all seven Agencies, 80 small infrastructure community development projects, 30 scholarships in business/management, and provision of 50,000 small loans.
- Providing technical support to private sector-led working groups examining ways to improve productivity in the marble and granite sector, and identify workforce development initiatives.
- Carrying out an assessment of the feasibility and scope of Reconstruction Opportunity Zones (ROZs) in FATA to promote investment and employment.

The total value of these various initiatives runs to almost US\$40 million.

While USAID interventions are focused on direct provision of services as well as creating opportunities for economic growth, ADB's strategy is geared more to building the capacity of FATA line departments and other relevant stakeholders to be able to deliver improved services and realize increased growth. ADB's most recent intervention in the FATA region is the \$60 million (of which 25% provided by Government, 75% by ADB) FATA Rural Development Programme. The project tackles the inefficient use of natural resources in the region, seeking to increase productivity at the same time as curbing environmental and resource degradation. Use of sustainable technologies, capacity building of Government line departments, community awareness-raising and organization, and support for new infrastructure/upgrading existing infrastructure are some of the initiatives to be undertaken by the project. The ultimate goal is to improve the quality of life for the people of FATA.

As seen, total committed donor funding for FATA comes to Rs.3.6 billion, leaving considerable scope for improvement. The FATA SDP prepared by the Government provides a coherent, integrated framework to ensure maximum effectiveness of donor funding.

9. Pakistan Development Forum 2007

The 2007 Pakistan Development Forum features, for the first time, a FATA Development Forum comprising Plenary and Roundtable Sessions. This is the first time FATA has been given such prominence in the Pakistan Development Forum, and is a reflection of the urgency for reform in the region. The Forum will discuss the challenges with regard to promoting development in FATA and recommend strategies for this. It will also be an opportunity for the Government to explain to the country's development partners its thinking for the future of FATA, notably the FATA Sustainable Development Plan, and to highlight the role they can play.

10. Useful Sources

Asian Development Bank. *Islamic Republic of Pakistan: FATA Rural Development Project: Report and Recommendations of the President to the Board of Directors*. (April 2006)

International Crisis Group. *Pakistan's Tribal Areas: Appeasing the Militants*. (Asia Report No. 125, December 2006)

Government of Pakistan. *FATA Sustainable Development Plan 2006-2015*. (2006)

Session VI(a): National Trade Corridor – Background Brief⁹⁹

⁹⁹ **Disclaimer:** This Background Brief has been prepared by Omer Javed for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information

Background and Context

Pakistan's economy has expanded by over 6.5 percent per annum during the past four years. A wide-ranging program of economic reforms launched in 2000 has played a key role in the country's economic recovery. These reforms have done much to boost Pakistan's share of total trade in GDP (rising to 30 percent in 2005). Exports have doubled in recent years, growing to about US\$14.4 billion in 2005, and investment has rebounded. To sustain sufficient momentum for this growth in the coming decade, the Government of Pakistan (GOP) is now focusing on reducing the cost-of-doing business and increasing productivity and international competitiveness.

The National Trade Corridor Improvement Program (NTCIP) is a major initiative launched by GOP to improve all national trade supporting infrastructure and services and this initiative includes the following broad sub-sectors: Ports and Shipping; Railways; Trade Facilitation (including customs); Highways; Aviation; Trucking (including motor vehicle registration and taxation, and warehousing); and Energy Logistics. NTCIP aims to reduce the overall trade-related transport and logistics costs; thereby, decreasing the cost of doing business and lowering the indirect losses being incurred by the economy resulting in trade competitiveness and industrialization.

Key Government Initiatives

There is growing recognition within the Government of Pakistan (GOP) that the country's ability to realize its economic potential is closely linked to the efficiency of its transport system. Accordingly, the Government has initiated a number of actions to address key constraints faced by the sector. These include:

- A new integrated transport policy is being drafted
- To increase infrastructure investments, including in transport, to about 4.0 percent of GDP by FY 2009-10, a Medium Term Development Framework has been developed and adopted
- Draft Road Freight Industry Policy prepared; first phase of RFI tariff restructuring completed; TIR commission established; Pilot overloading control program implemented by NHMP
- Draft Ports benchmarking completed; 15 % wet charges and 30 % free dwell time reduction notified, KDLB closure process started, and new dredger procured, by KPT
- PR first NTC entity to prepare draft Corporate Business Plan; Number of daily freight trains up from 1 to ~10; Railway PAX Fares increased
- N5 Road Corridor Improvement Plan (Expressway Corridor) appraised and approved; spot interdictions on N5 reduced
- FF Rules formulation by PIFFA and CBR started; SBP allows external remittance to FF; FF trainings organized

on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

- Customs Clearance times at KICT down from 4 d to < 1 d; 'Reefer Industry' tariffs restructured
- Medium Term Budgetary Framework based on 3 year rolling plans for infrastructure sectors to help with institutionalizing business plans.
- Railway salary increments for track/operations – in line with the current agreed business plan recommendations, but no mention of effect on overall PR Financial Framework or mitigation steps.
- Model 'Sabzi Mandis' (vegetable markets aka distribution/consolidation and deconsolidation centers) should be in the private sector otherwise government will again destroy one of the major opportunities available to improve Pakistan's internal and external trade logistics. It is not clear from the Budget speech if this opportunity exists or whether these will be state provided and operated.
- Custom duty reduction for refrigerated vans and exemption of all types of refrigerated units – good for improvement of an otherwise poor refrigerated logistics sector.
- Rationalization of duty on multi-axle trucks – this in line with the Road Freight Industry Policy being discussed with GOP under National Trade Corridor Improvement Program (NTC IP).
- Reduction of custom duty on buses, trucks and dumpers from 20% to 10% in CKD condition and from 60% to 30% in CBU condition – in line with the Road Freight Industry, policy being discussed with GOP under NTC IP.
- Budget clearly talks of the NTC and commitments to finance economic infrastructure; development of a plan for national trade corridor--GOOD SHOW!
- NTC related allocations are 31.5% of infrastructure development @ Rs. 37.6 billion as compared to Rs. 32.6 billion in 2005-06. A nominal increase, but good as we would rather that the NTC Improvement Plan (mentioned earlier in the budget) gels before any massive investments are undertaken.
- In wholesale and retail trade, exemption from customs duty in excess of 5% on import of equipments for establishing the wholesale/retail chain stores, like refrigeration system, fork lift trucks, high racks, fittings/fixtures, etc.--good move for development of Pakistan's internal trade logistics. All these are in line with the NTC Dialogue with GOP.
- Underpinnings of Customs Processing Automation and Post Clearance Audit have been strengthened. Very positive. Again a part of the NTCIP dialogue and the work under the TARP.

While progress has been achieved by respective Government agencies (in close collaboration with the private sector) under the 'National Trade Corridor Improvement Program' (NTCIP), initiated by the Prime Minister in August 2005, improving trade procedures and trade supporting infrastructure and services represents a key challenge for the transport sector.

NTC Objectives

The six-year plan, National Trade Corridor Improvement Plan (NTCIP), is being undertaken as a major strategic initiative to improve the logistics chain throughout the country to meet domestic transportation requirements and provide transit facilities to Central Asia, western China, Afghanistan and Iran. It covers ports and shipping, trade

facilitation, highways and trucking modernization, railways improvement and aviation and air transport modernization, along with energy logistics. The investment plan will be fully implemented in about six years and it is estimated to save 5 to 7.5 billion dollars per annum currently being lost owing to low performance of railways, highways, ports and airports.

As competition for global market share intensifies, it is essential for Pakistan to develop a carefully managed strategy for increased competitiveness and enhanced global integration aimed at accelerating industrialization and growth. Identifying and analyzing the elements that significantly impact the competitiveness of actual and potential export industries should facilitate the design of sector policies to improve export performance and ultimately overall economic growth.

Overall, determinants of export performance can be split into external and internal factors. External factors are mainly related to market access conditions and outside-the-border transport costs. Internal factors refer to supply side conditions. Supply capacity is affected by transport costs and service quality (including speed and reliability of delivery), entrepreneurship, capital and labor costs, and product quality as well as the role/performance of the export promoting institutions. These supply capacity elements have a significant and positive impact on export performance and thus, in turn, on the competitiveness of export products.

The cost and service level provided by the internal and external transport systems is just one element of a country's competitiveness. As tariff levels fall, so does the economic distance to market'. The transport sector covers roads, road transport, railways, ports and shipping (defined as the sum of all time and cost expenditures for moving a consignment to a market, including freight rates, handling costs, transit times, delivery predictability, loss and damage, insurance costs, etc.) plays a more and more critical role in determining competitiveness. While freight rates are still important in the final price of the product, the other elements of generalized costs, such as predictability and reliability, become increasingly important in the composition of total distribution costs.

An efficient, low cost trade and transport system, offering high levels of reliability and service standard, will not guarantee export success and the attraction of large scale inward direct investment. But, the reverse is likely to ensure that participation in modern high value, time-sensitive manufacturing will either be deterred entirely or confined to enclaves around international airports, dependent on air transport for export delivery, if not also the supply of imported inputs. Transport at internationally competitive levels may not be sufficient for the success of the development strategy adopted by Pakistan, but it is a prerequisite for Pakistan to become globally competitive, as outlined in the Medium Term Development Framework (MTDF), 2005-2010.

Pakistan, with 145 million people, has a reasonably developed transport infrastructure. Road transport is the backbone of Pakistan's transport system, accounting for 90 percent of national passenger traffic and 95 percent of freight. Two major ports, Port Karachi and Port Qasim, handle 95 percent of all international trade, and 14 dry ports cater

to high value external trade. A few oil pipelines - about 2,100 km in length – have a yearly pumping capacity of 6.0 million tons.

Transport is an important sector of the economy contributing 10 percent of the GDP and over 17 percent of the Gross Capital Formation. The sector consumes 35 percent of the total energy annually and is recipient of 20 percent to 25 percent of the annual federal public sector development program. The transport sector covers roads, road transport, railways, ports and shipping, and aviation. The sector has direct and indirect linkage with all important sectors of the economy, which influence economic and social development. An efficient transport system contributes to economic growth by lowering domestic production cost through timely delivery of raw materials (in agriculture and manufacturing sectors), enhancing economies of scale in the production process, and creating economic opportunities and communications links among people.

The total inland traffic by road and rail transport is currently estimated at 239 billion passenger-km of passenger traffic and 153 billion ton-km of freight traffic. Freight and passenger traffic has been growing at 6.24 percent and 6.65 percent per annum respectively. Road transport accounts for 90 percent of passenger traffic and 96 percent of freight traffic. The deregulation of the road transport services in the 70s has resulted in development of a competitive and vibrant private sector for goods and passenger transport. The road network is about 258,000 km with on-road vehicles at about 4.2 million.

Around 95 percent of the country's imports and exports are handled through the ports. The two existing national ports are handling about 40 million tons of cargo annually. Karachi Port, maintained by the Karachi Port Trust, handles about 30 million tons of cargo, while Port Qasim, maintained by the Port Qasim Authority, handles about 11 million tons. There are 44 airports maintained by the Civil Aviation Authority of which only 25 are operational. There is one major public sector airline and a few private airlines.

Over the past ten years, road traffic – both passenger and freight - has grown significantly faster than national economic growth. The 8,800 km long National Highway and Motorway network - which is 3 percent of the total road network - carries 75 percent of Pakistan's total traffic. There are 36 operational airports, one major public sector airline, and a few private airlines. The transportation sector accounts for about 11 percent of the country's GDP and 17 percent of Gross Capital Formation (GCF). It provides over 6 percent of employment in the country and receives 12 to 15 percent of the annual Federal Public Sector Development Program. Government agencies dominate the sector.

Major NTC Challenges

The performance of the transport system has been poor, with high economic losses from congestion and poor quality roads and a mismatch between supply and demand for transport services and supporting infrastructure. There are logistics constraints, which impede competitiveness of the country's trade and industrial development. The conventional system towards documentation clearance, movement facilitation and electronic data interchange is yet to be modernized. It is estimated that the inadequate and inefficient

transport system is imposing a cost to the economy in excess of Rs.220 billion annually or 8.5 percent of the GDP, constraining economic growth, reducing export competitiveness, and hindering social development. The development of an efficient transport sector has also been hindered due to misplaced priorities and the absence of an approved transport policy. Developing and implementing NTCIP, mainly pose the following four challenges:

- **The Efficiency Challenge** – Required reorientation of certain institutions not keeping pace with others and the overall plan
- **Public Resource Envelope Challenge** – In addition to ensuring PSDP allocations, need to find innovative off-budget and PPP (public private partnership) financing mechanisms to fully implement the identified programme within the fiscal responsibility framework
- **Private Sector Challenge** – Huge potential of savings (over USD 7 billion) resulting from efficiency in private sector logistics needs to be fully tapped – streamline areas such as warehousing, shipping, inventory control, and efficient administration
- **NTCIP physical infrastructure implementation challenge**

Although the sector is functional, its inefficiency, long waits and travel times, high costs, and low reliability are a drag on the country's economic growth. These factors reduce the competitiveness of the country's exports, and constrain Pakistan's ability to integrate into global supply chains which require just-in-time delivery. The poor performance of the sector is estimated to cost the economy 4-6 percent of GDP each year.

- **The poor performance and high costs of port operations are deterring trade.** Container dwell times - 11 days on average - are four times those in developed countries, and three times the average in East Asia. Of this, customs clearance alone takes 4-5 days as compared to 1.25 hours in Singapore. Port entry costs are 5-9 times more than some others in the region - vessel call charges in Pakistan are US\$30,000, in Jebel Ali they are US\$6,700, and in Salalah, Oman, they are US\$3,900. In addition, the ports' limited draught - at 9-12 meters - keep the latest and most efficient ships from calling. Redundant dock labor costs trade \$15-20/TEU.
- **Pakistan Railways (PR) needs to take major steps to improve the quality of freight services.** These include improving delivery times, reliability, tracking information etc. Presently, PR takes 21-28 days to deliver upcountry at a distance of 1800 km, which is 4 to 7 times slower than in China and the US. Freight rates in Pakistan, at 1-2 cents/ton-km, offer no real advantage over road transport which costs the same. In contrast, China rail is 2-3 times cheaper than road. As a result, the railways have a very low and stagnant market share, carrying less than 5 percent of freight and 10 percent of passenger traffic.
- **The quality of road transport services is low.** Over half the national highways network is in poor condition, and the road safety record is poor. The country's truck fleet is mostly made up of obsolete, underpowered, and polluting vehicles, and trucks are often grossly overloaded. Truck speeds are consequently slow, ranging between

20 to 25 kph compared to 80-90 kph in Europe, and journeys take three times longer than in Europe.

- **Informal and archaic trade practices are hurting Pakistan's competitiveness.** Transport insurance and related services constitute about 16 percent of foreign trade compared to 4-6 percent in the European Union. Potential annual savings through improved trade flows are estimated to be over one percent of GDP.

While reasonably adequate at this time, the transport system in Pakistan generates high economic losses due to a mismatch between supply and demand for transport services and supporting infrastructure. Also given the growth path Pakistan is following this system will soon reach capacity. Poor performance of the trade logistics sector significantly reduces the competitiveness of the actual and potential export industries. It is estimated that overall the inadequate and inefficient transport and trade logistics system is imposing a cost to the economy equivalent to 4 to 6 percent of the GDP. An overview of the sector performance is presented in the following paragraphs.

Road Transport: Although the nominal freight rates for trucking are relatively low compared to those in the region, poor quality and lack of reliability of services result in high overall cost of road transport for the economy. Domestic road transport represents a large share of the overall transport costs for imports and exports. For example, the transport of a bonded 20-foot container from Lahore to Karachi costs about 49 percent more than the ocean freight from Karachi to Dubai and represents approximately 45 percent of the ocean freight from Karachi to Rotterdam. Lack of reliability of road transport adds to the difficulty that Pakistan exporters have to meet short deadlines demanded by international buyers. The truck fleet is obsolete using technology that dates back to several decades ago. The average commercial running speed of vehicles is a low 25 km per hour compared to 80 km per hour in Europe. Truckers overload their trucks to generate some profit because of the high level of competition. Road crashes are frequent as trucks are in conflict with high volumes of slow local traffic. In case of emergency, exporters use special services that transport the goods in half the time but at a much higher cost, which adds to the cost of doing business and reduces the competitiveness of export industry.

Railways: The railway sector has lost its competitiveness overtime as the road network developed. Long delays and low speed are quite common in freight and passenger services. Pakistan Railways (PR) has been losing its market share to the road with rail representing about nine percent of the total passenger traffic and about four percent of the total freight traffic in FY03, down from respectively 41 percent and 73 percent in the sixties. PR has been unable to service its debt, to cover its full operating costs plus pension payments and to invest to renew its rolling stock. The Government has subsidized PR but not at a level sufficient to maintain and renew the track and the rolling stock. As a result, while PR has managed to keep the track in acceptable condition, signaling and telecommunication are obsolete creating safety hazards and delays. Freight wagons are old, in poor condition and designed for general cargo while most freight transport is now containerized and the transport capacity is largely insufficient to respond to the demand.

Highways: Maintenance of the highway network has suffered from insufficient funding and road users complain about overall poor condition of the highway network. In 2005, maintenance requirements for the federal road network were estimated at Rs 8.9 billion. Toll revenues represented about one third of these requirements (Rs 2.96 billion) and the Government allocated Rs 1.2 billion to road maintenance leaving an unfinanced gap of Rs 4.74 billion, about half of the requirements. As a result of the financing gap, road conditions have continuously deteriorated. A 2004-2005 survey of pavement condition on the federal network found that 47 percent of the network is classified in poor to very poor condition. Funding for network conservation and development has been insufficient as well. With an annual budget of Rs 25 billion for network upgradation, conservation and development, it will take eight years for the National Highway Agency (NHA) to execute its current portfolio of projects. This is unsustainable because roads will continue to deteriorate during this period and additional road works will be required for which no funds will be available.

Trade facilitation: While Pakistan has achieved considerable progress in simplifying its customs' tariff structure and reducing its tariff levels, customs procedures have remained cumbersome and an obstacle to trade. In 2004, a survey measured customs clearance time at four days on average. This is much higher than international benchmarks which are below a few hours. Delays were the result of a manual clearance system characterized by multiple windows, numerous official signatures and verifications (up to 36 signatures and 62 control steps) and an environment with limited accountability and transparency. Long customs procedures are also a source of congestion in the port areas. This was aggravated by 100 percent physical inspection of containers independently of the actual risk of fraud.

Civil Aviation: The growth of air traffic has remained modest in Pakistan although the sector should have benefited from the high economic growth. This is not consistent with the international experience which shows a strong linkage between air traffic and economic growth. While this may have been caused by the discontinuation of services by European and U.S. carriers in the last few years following the 9/11, the national airlines (Pakistan International Airlines-PIA) has not been able to capture the potential market created by the growth of the economy. Private airlines have been operating in Pakistan but due to their limited capacity and protection of PIA by the Government, they have not been able to develop services to respond to the demand. Domestic passenger traffic has grown modestly and in FY05 was still slightly below the level of FY01. International passenger traffic with 6 million passengers is only nine percent above the traffic in FY01.

Ports: The ports in Pakistan have started to take measures to improve their performance but still continue to contribute to the overall poor performance and high costs of the transport sector. Port costs are high compared to other ports in the region. Container handling charges in the port of Karachi are 1.5 to 3 times the charges in Colombo (Sri Lanka) or in the port of Nhava Sheva near Mumbai in India. Ship dues per ship calls are five times those in Sri Lanka and Hong Kong and 20 percent higher than in Nhava Sheva. Port productivity is also low with an average ratio of 55 containers handled per ship berth hour compared to a range between 65 and 100 in the three regional ports above. As a result, the utilization rate of port infrastructure is low. On average, the productivity of the quays in the container terminal of Karachi is 400 TEU per meter compared to 1,000 in Sri Lanka and

around 2,000 in India and Hong Kong. The low productivity reflects the long times spent by containers on the quays. As a result, dwell times measuring the time spent by containers in the port were around 9 days in 2006 in the Karachi Container Terminal compared to 5 days in other regional ports.

The vision for the transport sector is the establishment of an efficient and well integrated transport system that will facilitate the development of a competitive economy and poverty reduction, while ensuring safety in mobility. The strategic thrust is on optimal utilization of the existing capacity, improved management for maintenance and operation and coordinated use of various modes of transport. Private sector participation in the sector would be enhanced and institutional capacity building and Research and Development activities undertaken to enhance sector efficiency.

The main weaknesses of the present transport system in relation to what might be termed “international norms” can be summarized as follows:

- High port costs and high port profits, resulting in higher charges to users than might be considered as desirable in terms of overall economic policy, increasing openness to the world economy and stimulating trade;
- Long dwell times for inbound containers, resulting in congested terminals and the need to construct additional facilities;
- Ports with relatively shallow draft, which will increasingly limit shipping connections as the size of container vessels on direct services increase;
- A weak, fragmented and relatively under-developed freight forwarding/logistics sector, which has yet to provide the breadth of services and levels of vertical integration which are increasingly found elsewhere;
- A fragmented approach towards trade facilitation with improvements to be made in the public private forum on trade facilitation issues, the National Trade and Transport Facilitation Committee (NTTFC);
- A main road infrastructure which requires major investment to provide the capacity and quality required for rapid and reliable road services;
- A trucking sector, operating old and technologically outdated trucks, which offers low freight rates but long transit times and unreliable service quality unless shippers are prepared to introduce additional and costly measures;
- Import regulations and tariff structures that inhibit the modernization of the trucking fleet;
- A trucking sector which **has** low private costs but high external costs in terms of vehicle overloading, leading to road damage and high accident rates, and congestion;
- A rail system with the haul distances and engineering standards which should provide the potential for rail to take a substantial share of the long distance freight market but carries insignificant levels of freight traffic and has been largely abandoned by the private sector.

Opportunities

In order for Pakistan to improve upon its trade competitiveness to ultimately boost its growth rates and hence ensure sustained development, it needs to take advantage of all the opportunities that are offered by the NTCIP sub-sectors. Therefore, prudent policies and efficient implementation is required to address issue areas in each and every sub-sector. It is only through upgrading our systems in terms of these sub-sectors that these can be allowed to serve as opportunities of development for us.

Trade Facilitation and Trade Logistics

- Reducing port dwell time and charges
- Strengthening the public-private partnership on trade facilitation
- Enhancing services in the logistics sector
- Enhancing trade facilitation
- Increasing efficiency at dry ports
- Establishing performance monitoring indicators and benchmark.

Ports and Shipping

- Improving port management
- Updating the National Ports Master Plan
- Closing the Karachi Dock Labor Board (KDLB) by using a mutually agreed separation scheme
- Improving port
- Completing the transformation of the KPT
- Raise the level of port and commercial/marketing professionalism at both ports
- Establishing performance monitoring indicators and benchmarks

Railways

- Establishing a reform team and preparing a restructuring plan
- Developing a Business Plan and Marketing Strategy
- Transforming its present departmental structure and governance
- Treating infrastructure cost recovery on an equal basis for road and rail
- Introducing modern financial management and accounting
- Resolving the social and strategic cost of keeping loss-making lines/service open for business

Trucking

- Rationalizing truck import tariffs and removing the deletion
- Allowing import of second hand equipment
- Improving trucking regulations
- Initiating and implementing truck modernization

Strategic Thrust: The Way Forward

Some of these shortcomings can only be removed by investment, others (for example, the revitalization of the railways) by both investment and policy change, while others require mainly policy change and the freedom for the private sector to make their own decisions and investment. Investments are relatively uncontroversial, given that they only require funding and funding sources. On the other hand, many of the policy changes, necessary to streamline systems, may be more difficult to agree and implement as they may adversely impact entrenched interests in maintaining existing systems. Investments alone are, however, unlikely to bring the level of change required where policy change is essential to achieve the full potential. With the implementation of NTCIP, it is estimated that savings to the tune of Rs. 200-250 billion annually will be made. This will include Rs. 145 billion per year from highways, trucking and railways improvement; Rs. 27 billion per year from port's improvements; and Rs. 75 billion per year from improvements in trade logistics.

Efforts to increase Pakistan's competitiveness, especially of its exports, require a systematic approach that takes into account both common and trade specific impediments to efficient trade and transport logistics. Such efforts must look beyond improvements in transport infrastructure towards a general strengthening of the entire supply chain while incorporating three elements of trade facilitation, namely harmonization, simplification and standardization of trade procedures, and improvements in logistics. The efficient functioning and market structure of the ports, railways and road system as well as improvements in trade procedures and logistics services are at the heart of increasing competitiveness of exports, thus improving the general trading environment.

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'Pakistan's Trade Competitiveness in Pakistan: Analytical Underpinning for National Trade

Session VI(b): Water, Power and Prosperity – Background Brief¹⁰⁰

Pakistan's economy has shown exceptional growth in the past few years, attributed mainly to the consistency in policy environment and stabilization of major macroeconomic indicators. Buoyant growth, improved macroeconomic fundamentals, and strengthened international credit ratings have been the economy's hallmarks in recent years. Focus is now shifting to the issues involving sustaining this tremendous performance. The Government recognizes the importance of improving and expanding infrastructure services in various sectors for sustaining economic and social development. Nowhere else it is more crucial to sustaining high growth in the country, as it is in Water and Power sector.

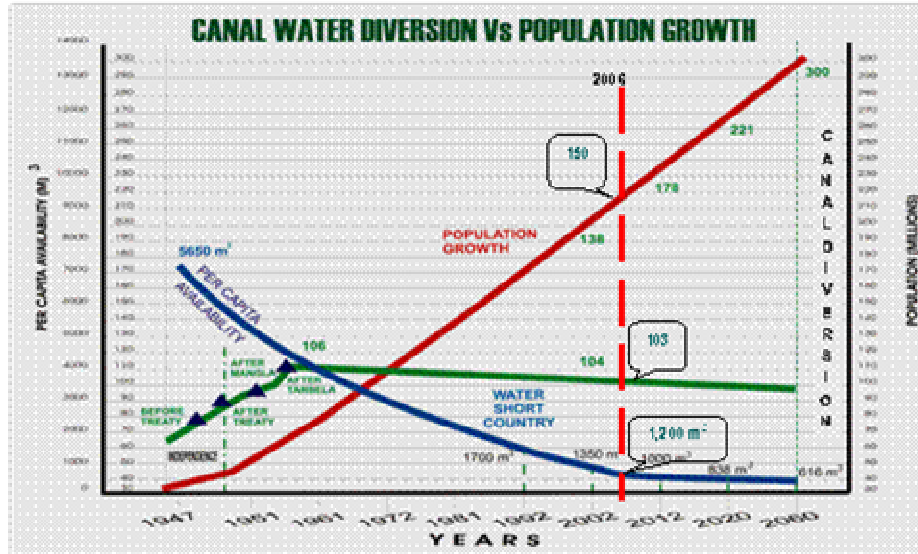
Water is increasingly becoming scarce in Pakistan and the frequent occurrence of droughts is posing a threat to the economy because of our dependence on hydropower and irrigation. The water shortages registered during the last few years were as high as fifty percent¹⁰¹. The decreasing trend in rainfall since 1997, population growth, lack of consensus among the provinces on the construction of new dams and silting of the two major dams are the principal reasons of water scarcity in the country. On the basis of rapidly increasing future demands, experts contend that this situation is unsustainable and before long will have disastrous effects for the national economy.

As shown in figure below, the population of Pakistan which was only fifty million in 1960 has increased threefold to more than one hundred and fifty million. This massive change has led to decrease in per capita water availability from 5,650 m³ in 1950 to 1,200 m³ by 2006. This value will further decline to 838¹⁰² m³ by 2020 if no new dams are constructed on the major rivers and the available water resources are not used wisely.

¹⁰⁰ **Disclaimer:** This Background Brief has been prepared by Zulfiqar Shaikh for the Economic Affairs Division (EAD) to provide information about the main themes being discussed at the 2007 PDF. An attempt has been made to compile and present relevant and accurate information. However, the Ministry accepts no responsibility for the information given in this Brief. Furthermore, the content should not be construed as the official position of the Government of Pakistan or its related organizations and agencies. Official information on the Government's policies, plans, strategies and perspectives can be obtained from the concerned ministries and/or other published material of the Government of Pakistan.

¹⁰¹ Javaid and Yamin. 2003.

¹⁰² According to the United Nations System in Pakistan, countries are classified as Water Short if the annual per capita water availability is less than 1,000 m³.



Water Availability and Population of Pakistan, 1947 to 2060

Table below shows the shortfall of water in Pakistan will face. In view of these statistics, water resources development and proper management has acquired a new significance and urgency. Considering only the agriculture sector, this loss of water will lead to a shortfall in all major crops. Around eleven million tons of crop reduction will be faced by 2010 and sixteen million tons by 2020.

Water Requirement and Availability in 2000 – 2025

Parameters	Years		
	2000	2010	2025
Population (million)	137	170	208
Water Requirements (MAF ¹⁰³)	149	215	254
Water Availability (MAF)	109	108	127
Shortfall (MAF)	40	107	127

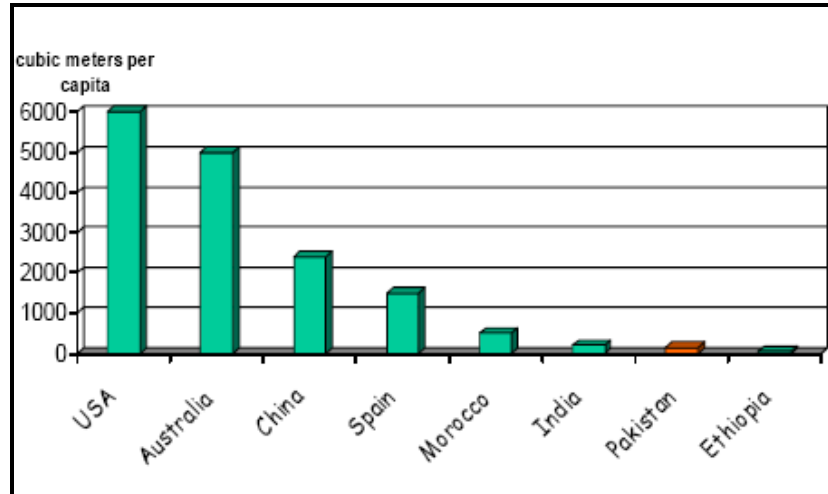
Source: Haq et al 2000 and Bhutta & Sufi 2004

Lack of surface water storages

Where river flows are variable, like in Pakistan, storages are required so that the supply of water can more closely match water demands throughout the year. On average 39.58 billion m³ (BCM) of water escapes to the sea every year due to lack of storage capacity. Comparing

¹⁰³ One acre foot = 1,233 m³

with other countries, Pakistan has inadequate water storage capacity. As illustrated in figure below, the United States and Australia have more than 5000m³ of storage capacity per capita, and China has 2200m³. Pakistan has only 150m³ storage capacity per capita which is even less than that of India's smaller capacity of around 200m³.



Storage per Capita in different Countries

Source: The World Bank, 2005

Moreover, duration of water storage in the Indus River System is also very small. It is only for one month as compared to the storage duration for the Colorado and Murray–Darling Rivers, which can hold thirty months of river runoff. South Africa can store upto sixteen months of runoff of its Orange River and India between four to seven months for its major rivers.

Water Losses

According to the experts, water conveyance loss is 23 MAF every year out of the total 106 MAF water annually diverted into canals. A further 35 MAF of water is lost in watercourses during its transit from the outlets (mogha) to the fields. Water availability at the farm-gate comes to 92 MAF after adding forty four MAF of groundwater, extracted from seven hundred thousand tube-wells in the country. Out of which about 28 MAF is wasted during field application inefficiencies caused by:

- i. Undulating topographic features
- ii. Improper farm layout/design
- iii. Poor drainage facilities
- iv. Delayed & prolonged sowing

Actual amount of water used by farmers for land preparation is often several times higher than the requirement. According to an estimate¹⁰⁴, farmers in Pakistan apply about seven to eight acre-feet of irrigation water for growing rice, against recommended application rate of four to five acre-feet. On an average, about two to three acre-feet water is applied in excess

¹⁰⁴ Kahlown, M. A. et. al. 2000.

and wasted due to seepage, deep percolation, evaporation etc. Similarly, more than two acre-feet of water is applied in producing wheat against recommended water requirement of about around one and one and a half acre-feet of water. This means that half to one acre-feet of water per acre is being wasted in producing wheat crop which is direct loss of available water at the farm. The same is also true for other major crops.

Loss of capacity for sedimentation

When the Indus Basin Works were being planned, it was clear that the construction of Tarbela and Mangla was not a final solution to the future water demands of the country. Like all dams, these structures are being silted up with the passage of time. It is believed that six MAF of storage capacity will be lost by 2025. Each MAF of storage capacity lost means one MAF/year less water that can be supplied with a given level of reliability, necessitating immediate replacement of storage capacity.

Sedimentation in the three major reservoirs i.e. Tarbela, Mangla, and Chasma is gradually declining their storage capacities and by 2010 the storage capacity of the above reservoirs will be reduced to 3/4th of their original capacity as depicted in Table 2.2. There is a dire need to re-assess the storage demand and take immediate steps for the continuation of regular water supplies to the irrigation-system. It is unfortunate that Pakistan has not captured the opportunity to construct additional storages during the last four decades as envisaged at the time of the Indus Waters Treaty.

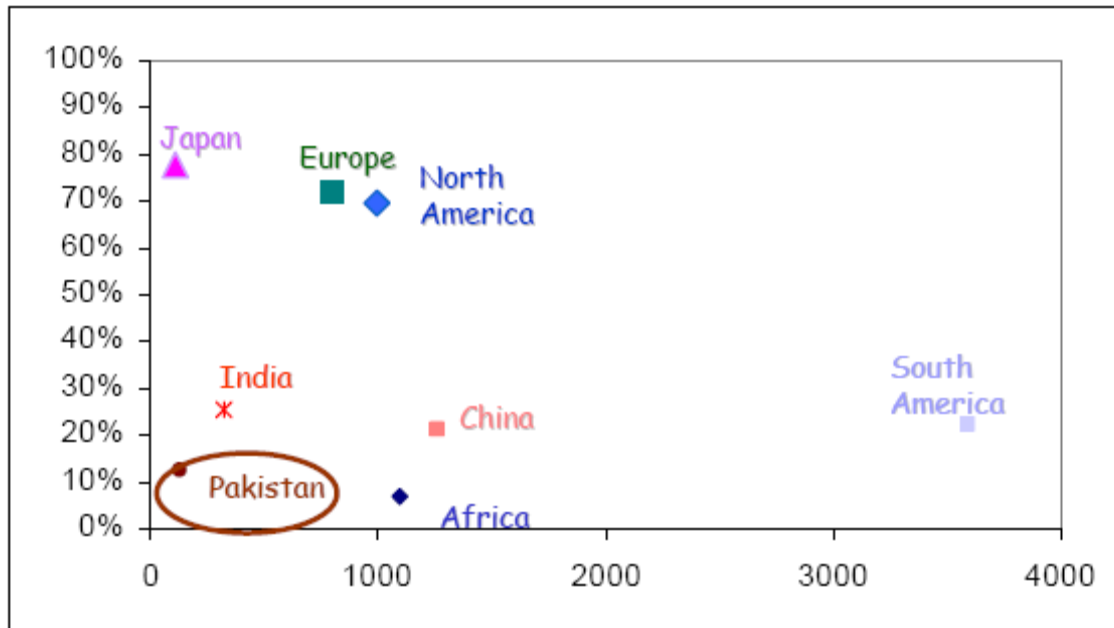
Reduction in Storage Capacity of Major Reservoirs in MAF

RESERVIORS	GROSS STORAGE CAPACITY		PERCENTAGE STORAGE LOSS		
	ORIGINAL	2005	2005	2012	2025
TERBELA (1974)	11.6	8.3	28%	35%	46%
MANGLA (1967)	5.9	4.6	22%	29%	34%
CHASMA (1971)	0.9	0.5	46%	55%	57%
TOTAL	18.4	13.4	27%	34%	43%

Source: Pakistan water strategy

Under-exploited hydro-power potential

The total installed power generation capacity in Pakistan is 17,457 MW. This includes hydropower generation capacity of 5,013 MW, thermal power generation capacity of 12,169 MW and nuclear power generation capacity of 462 MW. Based on the present generation capacity, the hydronuclear/thermal mix in the country is 29:71 whereas it should have been other way round. As shown in figure, Pakistan has used only 5,013 MW (12.5%) of its estimated 40,000 MW of hydropower potential, a proportion much lower than that of India (25%), China (20%) and Japan (75%). Hydropower is not only much cheaper but is also more environment friendly than thermal plants which emit carbon dioxide and other greenhouse gases.



The Development of Economically Feasible Hydropower Potential in Pakistan in International Context

Source: The World Bank, 2005

Deteriorating Ground-water Quantity and Quality

Moreover, over the past 40 years the exploitation of groundwater, mostly by private farmers, has brought enormous economic and environmental benefits. But now the water quantum that was gradually decreasing has reduced to half. Furthermore, there are serious and growing problems with groundwater quality, a reality that is likely to get worse because there are 20 million tonnes of salt accumulating in the system every year. There is an urgent need to develop policies and approaches for bringing water withdrawals into balance with recharge, a difficult process which is going to require action by government and by informed and organized users.

Government of Pakistan Initiatives

As discussed above, water shortage has increased in recent years and unless a comprehensive and integrated policy is devised and implemented, the long-term forecast is even bleaker. If current conditions continue, very survival of one out of the people in Pakistan will be in question due to shortage of not only water but also of hydro-electric power. Moreover, there is a danger that the country has entered a dry cycle and even the current precipitation rates would fall, resulting in drought-like conditions every six years. Due to the last drought, four million people in Karachi have to drink brackish water. Situation in Baluchistan is also very dangerous as level of underground aquifers is dropping 3.5 meters annually. At this rate, aquifers are likely to run out in fifteen years, leaving millions of lives in jeopardy¹⁰⁵.

¹⁰⁵ Pakistan water gateway website. 'Water crisis: A special report'. URL http://www.waterinfo.net.pk/full_report_water_crisis.htm

The successive droughts have highlighted the absence of any comprehensive water policy in the past and have exposed serious shortcomings in Pakistan's water supply, sanitation, storage and irrigation systems. Inefficient use, unequal distribution and absence of a reliable, transparent monitoring system have generated tensions to such a level that some pundits have expressed doubts about the future of Pakistan.

Medium Term Development Framework 2005-10 on Water

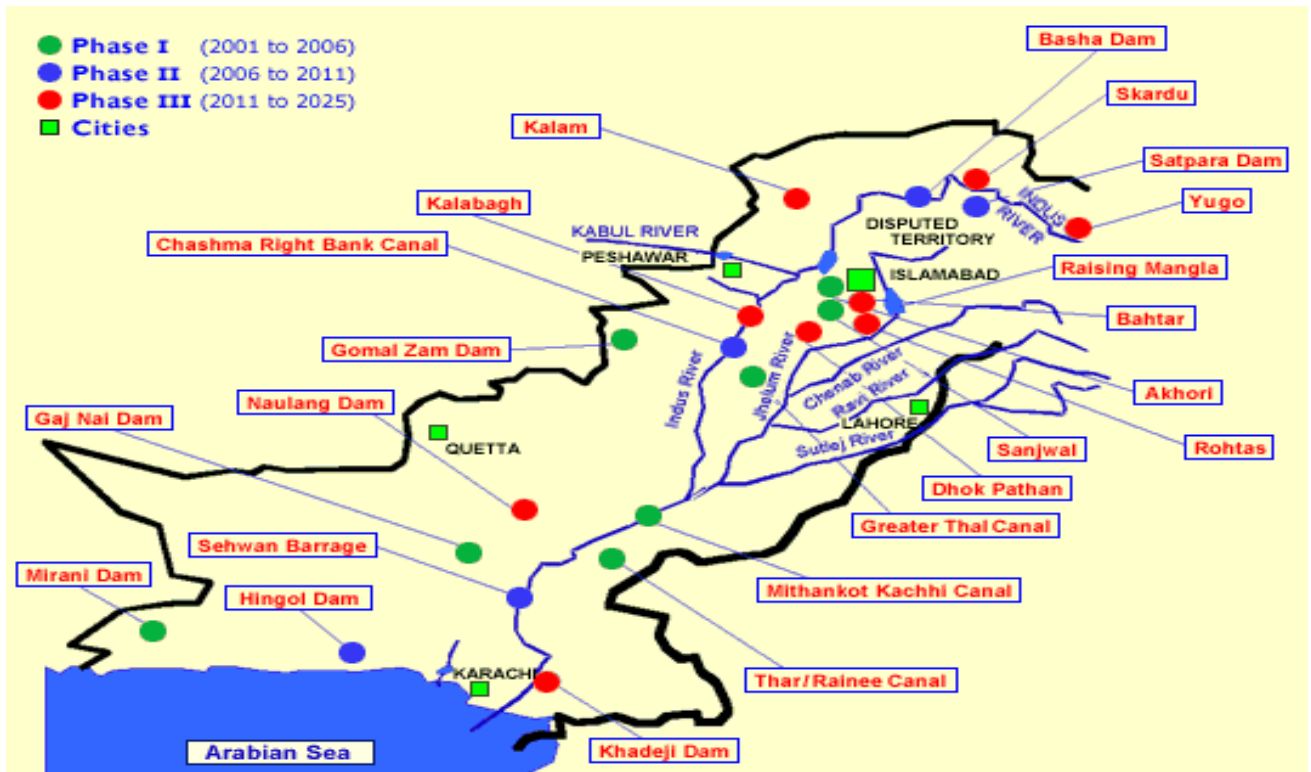
Substantial importance has been given to water resources management in devising the medium term development framework. The key issues that have been addressed in MTF 2005-2010 include:

(a) the need for a holistic, integrated and sustained approach, (b) sub-optimal use and low productivity of water, (c) inadequate storage capacity with water escapees to sea, (d) extensive seepage losses in the irrigation system, (e) inadequate operation & maintenance and poor cost recovery, (f) excessive groundwater pumpage without groundwater recharge (mining of groundwater), (g) absence of measures for rainfall harvesting, (h) unsafe disposal of drainage effluent to the sea, (i) inadequate protection of infrastructure from floods, (j) lack of private sector participation, (k) deteriorating institutional capacities of key water sector institutions, (l) increased poverty in backward irrigated areas, and (m) poor linkage among water, agriculture and rural development projects and related research.

Vision 2025

This document envisages Pakistan having adequate water available by 2025 through conservation, development of new resources and good governance. Water supplies should be potable, equitably distributed and meet the needs of all users through an efficient and integrated management. There should be an institutional and legal system in place that would ensure sustainable utilization of the water resources and support economic and social development, with due consideration to the environment, quality of life, economic value of resources, ability to pay and participation of all stakeholders. WAPDA has identified thirty seven projects under this vision which will be completed in three phases. The following map shows the locations of these projects¹⁰⁶.

¹⁰⁶ WAPDA website URL <http://202.38.50.35/vision2025/default.asp>



Draft National Water Policy

In the context of reform program supported under Poverty reduction Strategy Credit (PRSC), the federal government devised a national water policy for developing a consensus on future developments in water sector. National Water Policy aims include:

- Efficient management and conservation of existing water resources;
- Optimal development of potential water resources;
- Equitable water distribution in various areas and canal commands;
- Measures to reverse rapidly declining groundwater levels in low-recharge areas;
- Effective drainage interventions to maximize crop production;
- Improved flood control and protective measures.
- Steps to ensure acceptable and safe quality of water;
- Institutional reforms to make the managing organizations more dynamic and responsive.

To achieve these objectives, NWP has identified several broad areas and formulated policy responses for each of them. These areas include integrated planning and development of water resources, irrigated agriculture, municipal & rural water supply/sanitation, water for industry, water for hydropower, water rights and allocations, economic & financial management, groundwater, stakeholders participation, flood management & drought management etc¹⁰⁷.

¹⁰⁷ Pakistan water gateway website URL <http://www.waterinfo.net.pk/pdf/NationalWaterPolicy.PDF>

Policy for Development of Renewable Energy for Power Generation, 2006

In 2006, the Ministry of Water and Power has introduced the first ever Renewable Energy Policy of Pakistan, which envisages mainstreaming of renewable energy in the development plans of the country. The policy comprises of three phases: short, medium and long term. The short term policy, which covers the period up to June 2008, lays down very liberal and attractive incentives to attract investment to put Pakistan on the renewable energy map of the world. Based on the experience gained under the short term, the policy for the next phases will be consolidated and elements of competition will be introduced.

Saliently, the Renewable Energy Development policy:

- i) invites investment from the private sector within Independent power projects (IPPs), captive power projects, Isolated grid power projects;
- ii) permits an investor to generate electricity from a renewable resource at one location and receive an equivalent amount at another location for the same cost;
- iii) allows net metering and billing so that a producer can sell surplus electricity at one time and receive electricity from the grid at another time while settling accounts on net basis. This will directly benefit the economics of small scale, dispersed generation and optimize capacity utilization of installed systems)
- iv) delicens and deregulates small scale power production through renewable resources (up to 5 MW for hydro and 1 MW for net metered sales) to reduce the transaction costs for such investments.
- v) lays down simplified and transparent principles of tariff determination.
- vi) insulates the investor from resource variability risk, which is allocated to the power purchaser.
- vii) facilitates projects to obtain carbon credits for avoided greenhouse gas emissions, helping improve financial returns and reducing per unit costs for the purchaser.

These guidelines are in line with the Government's open door policy for inviting private investment into the country. It will go a long way in strengthening and improving the power supply position of the country and help fuel rapid and environmentally sustainable economic growth.

Pakistan Water Sector Strategy

This strategy provides a road map for the future development of the water sector. This strategy is based on the following three main documents:

- **National Water Sector Profile (NWSP)** which gives an overview of all aspects of the current water availability and utilization. As such, it forms the baseline scenario from which informed decisions about future can be taken.
- **National Water Sector Strategy (NWSS)** broadly identifies with the draft national water policy. It first details the key issues and objectives for the water sector and then gives recommendations for planning, use, development and management of water resources.
- **Medium Term Investment Plan (MTIP)** is the short term implementation plan of NWSS. It lists the programmes/ projects which should be started before 2011 to achieve the initial objectives of the NWSS¹⁰⁸.

¹⁰⁸ Pakistan water gateway website URL <http://www.waterinfo.net.pk/splight4.htm>

In addition to the above policy initiatives, federal government has started the following projects and committees to improve water efficiency in the country.

Clean Drinking Water for All

The aim of the project is to provide potable water to the whole population of Pakistan. This three year project was approved in 2004 and its costs are Rs. 115 million. Initially, under this project, 121 water purification plants of 2000 gallons per hour capacity were to be installed, one in every district in Pakistan¹⁰⁹. Later on, the project was extended and now in the first phase, to be funded and executed by the federal government, filtration plants are to be installed in every tehsil. In the second phase, which will be funded by the federal government but executed by the provincial governments, filtration plants will be installed in every union council¹¹⁰. Till now, 233 filtration plants have been installed and 90 are near completion¹¹¹.

Construction of Mega Dams

Pakistan has used only about 10% of its estimated 40,000 mw of economically viable hydropower potential, a proportion much lower than, say, India and China (around 30%) and much lower still than rich countries (around 75%). Existing hydro-power generation is unable to meet the increasing demand due to rapidly growing economy and rising population. At the same time, the capacity of existing reservoirs is shrinking because of silting. Considering these aspects along with aspects of water shortages and storage capacities' inadequacy, the government has started working on construction of mega projects. The Cabinet has already approved the decision of building five Multipurpose Water Reservoirs in the country by the year 2016.

Five Mega Dams in Pipeline

The five multipurpose Water-Reservoir projects approved by the Cabinet include: Diamer Basha Dam with the expected 4500 MW power generation capacity and expected cost of US\$ 6.5 billion, Kalabagh Dam with the expected 3600 MW power generation capacity and expected cost of US\$ 6.0 billion, Akhori Dam with the expected 600 MW power generation capacity and expected cost of US\$ 4.2 billion, Munda Dam with the expected 740 MW power generation capacity and expected cost of US\$ 885 million, and Kurram Tangi Dam with the expected 83 MW power generation capacity and expected cost of US\$ 327 million. The first three dams are planned to be built on Indus River, while Munda on Swat River and Kurram Tangi will be constructed on Kurram River. The total cost of these five mega projects is summed at massive US\$ 18 billion. Work on technical designing of Diamer Basha has started and is expected to complete by 2008, while feasibility stage-I has been completed. (There has been upward revision in the cost of the dam and its designing due to project area

¹⁰⁹ Ministry of Environment website URL http://www.environment.gov.pk/PRO_PDF/CDWA-Briefs.pdf

¹¹⁰ Brief (unpublished) for chairman, P&D for the provincial steering committee meeting on clean drinking water project

¹¹¹ Ministry of Environment website. Progress report. URL <http://www.pakistan.gov.pk/ministries/environment-ministry/media/clean.htm>

being in seismic zone.) Government is resolute to complete these projects within the timeframe, while working to explore financing modes.

Infrastructure Project Development Facility

Recognizing the importance of improving and expanding infrastructure services for sustaining economic and social development in its Medium Term Development Framework(MDTF) 2005-2010, it has established Infrastructure Project Development Facility. IPDF is the government's key PPP implementation agency, under the auspices of the Ministry of Finance (MOF), which will help public sector agencies from all tiers of the Government generate projects. IPDF aims at generating Public Private Partnership (PPP) projects with Implementing Agencies (line ministries, provincial Governments, local bodies, state owned enterprises etc.). Recognizing Pakistan's massive infrastructure needs and its limited resources, IPDF has been established to not just to address limited fiscal space, but also huge gaps in public sector capacity to build and operate infrastructure. Like in building any other massive infrastructure, water sector faces Government's tight fiscal constraints and requires innovative approaches - away from the traditional role of the Government as the service provider - to ensure that the massive investment needs are financed with the assistance of the private sector. Besides leveraging private financing, the Government's Programme objectives include more, better, affordable and timely services to all citizens through improved infrastructure.

Electricity Export

Along with natural increase due to population growth, Pakistan's electricity demand has increased many folds due to exceptional economic growth. Although Pakistan is developing large hydel and thermal power stations to meet the future demand, import of cheap electricity from Central Asia has been considered as one of the priorities to enhance future generation capacity. Afghanistan has showed willingness to provide its territory for electricity transit from CASs. A number of tariff structures are under study for transmission project e.g two part tariff, single tariff and power purchase & wheeling. In this regard, to promote the feasible option of Public Private Partnership, option of adopting IPPs, which do have sufficient experience and framework in Pakistan, for the proposed Power Import Infrastructure is also being given serious consideration. To materialize such PPPs, a careful risk analysis needs to be performed to determine the nature of risks the various governments and the stakeholders would have to bear.

Issues and Challenges

Financing Issues of Mega Dams

In the past, most infrastructure projects were mainly sponsored directly from public expenditure by the governments. In recent years though, there has been a trend to explore private sector financing for the purpose. Pakistan's much needed investment in Water sector and subsequently in mega power-generation projects calls for adoption of such alternatives. In this regard, Government of Pakistan has commissioned a Task Force on Financing of Water Reservoirs to asses various possibilities of financing construction of mega Dams.

Infrastructure Project Development Facility (IPDF) has been established to explore opportunities in Public Private Partnerships. IPDF is actively involved in the Task Force on financing these mega hydro-power projects and has taken governments' initiatives at higher levels.

Along with the future construction of Mega Dams projects, concept of building many small dams, as is practiced in China and Turkey, is also important and is gaining attention from policy-making spheres. This way much of the self-sufficiency in the local areas can be achieved. Recent completion of Subakzai dam in Balochistan is commendable and government plans to heed in this direction.

Other Issues in Power Sector

Government's strategy is to deliver more reliable and affordable power supply not only to households, but also just as important to businesses. Focus is being given to removing transmission bottlenecks to power delivery, rehabilitate and expand parts of the country's transmission system to meet present and anticipated future demand and ensure the system's continued operation and maintenance.

The Government is fully committed towards encouraging the use of hydel, coal and gas reserves for power production, and to reduce the losses of power sector utilities. These are the key elements of the

While hydro-power potential in Pakistan is much untapped and is likely to yield substantial returns, in view of the growing energy demand other alternatives need to be explored. In this respect, Government has decided to utilize gas, hydel, coal, windmill and even furnace oil for catering to growing needs of the power sector. Renewable energy opportunities are increasingly gaining importance and the Government has responded well to lay down the policy framework embedded with incentive mechanisms.

Legal and Regulatory Framework for Water Sector

The water sector laws framed in Pakistan provides a comprehensive legal framework so far as the definitions of the objectives and legal provisions are concerned. There is, however, a dire need to provide a legal framework to regulate pumping of groundwater which is adversely affecting aquifers. Sectoral policies are also present but lack both in terms of practicality and implementation. Water sector strategy is a comprehensive and well-researched document but implementation of its recommendations by the government remains doubtful. The environmental legislation also needs certain improvements such as:

- Improvements are required in clarity and depth. Certain rules/standards do not have detailed and in-depth implementation mechanisms to facilitate proper understanding and compliance and are lacking tangible checks to quantify the amount of violation.
- There is duplication in responsibilities among various public sector institutions, which creates conflicts and confusion among them and subsequently affects the efficiency. This over lapping of responsibility and functions should be removed.

- Existing standards like NEQS (National Environmental Quality Standards)¹¹² do not have provisions for riverine and irrigation water quality, potable water, and groundwater recharge quality standards. New environmental legislation should be enforced to back up and promote the existing regulations.
- Effective enforcement of legislation is not possible until it is fully backed by well-defined and sustainable monitoring mechanism. Therefore, a proper monitoring framework is required for all legislation. For example, existing NEQS have not been enforced fully.

Legal and Regulatory Framework for Water Sector

To improve governance in water sector, one of the important policy actions Asian Development Bank recommends is capacity building of water sector organizations¹¹³. All public sector water institutions of Pakistan are in dire need of capacity building. It is unfortunate that the decision-makers who are frame policies, laws and regulations have little or no opportunities to update and refresh their knowledge. The training component, which should have been a priority item, has been neglected over the years either due to lack funds, ignorance or interest. There is a need for specialized courses and trainings to be offered from time to time to update the public officials of new developments in the water sector.

It is suggested that public sector training institutions, such as the Punjab Engineering Academy and WAPDA training centres, should be re-organized and strengthened to enable them to not only impart professional trainings themselves but also facilitate trainings by other institutions such as IWMI (International Water Management Institute), Centre of Excellence in Water Resources, Pakistan Council for Research in Water Resources (PCRWR) and Pakistan Agriculture Research Council (PARC) etc.

Legal and Regulatory Framework for Water Sector

There is little coordination between the ministries, autonomous bodies, agencies and departments, both at the federal and provincial levels. Although the Ministry of Water & Power has certain linkages with the provincial irrigation departments and the federal environmental protection agency (EPA) has a coordination network with its provincial establishments, coordination between the center and provinces is very weak due to political and bureaucratic reasons. An integrated approach and proper coordination mechanism in all institutions related to water sector should be put in place to get maximum benefits out of the limited resources. The federal government is required to focus more on development of umbrella projects addressing issues in a holistic manner rather than adopting piecemeal approach and developing several projects with similar components.

¹¹² Cleaner Production Program website. URL <http://www.cpp.org.pk/legal/RevisedNEQS.pdf>

¹¹³ ADB website. URL <http://www.adb.org/water/cfws/water-sector-reforms/tracking-progress-phase-one-references.asp#governance>

Regulation of agriculture and irrigation activities is handled in separate administrative ministries/departments which have little interaction, both at the federal and provincial level. The personnel of the agriculture and irrigation departments also operate almost independently in the field. Moreover, both engineering and agriculture universities have failed to train their irrigation engineers and agronomists about developments in each other's field. Thus there is poor co-ordination between the two main components of irrigated agriculture at academic, administrative and operational levels. Constant interaction between these two areas can be very beneficial. For example, agriculture extension, which has a large network in every province, can be utilized for trainings related to better management of water resources and efficient methods of irrigation. Research studies carried out by WAPDA, PCRWR and irrigation departments which are seldom utilized by the agriculture departments can help both these departments achieve their objectives.

Legal and Regulatory Framework for Water Sector

In the water sector, conservation practices are very important due to the scarce water resources and inefficient usage in Pakistan. Despite the overall shortages, the overuse of water in irrigation and indiscriminate use of potable water are major problems in Pakistan. This results in not only the wastage of water, but it also leads to water logging and salinity, pressure on sanitation infrastructure, epidemics and wear and tear of roads. There is also a need to reduce the water leakage and losses from the water supply systems.

The gap between total water requirements and availability in Pakistan which was 40 MAF in 2000, would reach 127 MAF (refer Table 2.1) by 2025. This necessitates enhancing water use efficiency both in irrigation and water supply. This will require a concerted effort in watershed management to reduce degradation of upper catchments so that runoff is moderated and sedimentation is minimized. The greatest effort in water conservation should be made in the irrigated agriculture sub-sector because this is by far the largest user of water. Even relatively modest improvements in irrigation efficiency will result in significant reductions in water use which can then be reallocated to other uses, primarily urban and rural domestic water supplies. Moreover, over irrigation has led to a reduction in crop yields, lowering overall agricultural productivity. Increasing irrigation efficiency, therefore, will result in improved crop yields and allow more areas to be irrigated, thus increasing agricultural output. For example, during the drought of the late 1990s, wheat yields actually increased in the Punjab because the crop was over-watered in the past, literally drowning the root zone. Farmers are likely to resist because they are not trained in the new methods, or worry about affordability of drip irrigators or sprinklers but awareness campaigns, increasing yields and less payment of abiana will convert them.

To deal with these issues, should Pakistan increase water charges as advised in 'Global Water Outlook to 2025' report¹¹⁴? In Pakistan, water is highly subsidized, both in domestic and irrigation sub sectors. Moreover, groundwater is a free commodity, which should be managed as a national resource. Conservation can also be adopted through developing a realistic pricing system. Abiana and water charges are kept at a bare minimum due to political pressures and mass poverty. However, it is important to understand that consumers will only take the ownership of conserving water resource, if they have to pay for non-conservation. It

¹¹⁴ Rosegrant, M. W. et. al. 2002. *Global Water Outlook to 2025*. International Food Policy Research Institute

is suggested that water pricing structure should be such that the basic requirement per capita be kept at reasonably low rates to allow adequate usage and the basic facility to the poor. However, the charges should increase in various slabs to discourage wasteful use of water. It is also recommended that groundwater regulatory frameworks be developed for all provinces and charges should be imposed in similar slab-structure to conserve the groundwater resource as well.

Legal and Regulatory Framework for Water Sector

There are few research organizations in the country, which are focusing on water sector and they are also facing shortages of funds and professional staff. Most of the developments in the water sector are based on primitive engineering knowledge or research done in developed world. A lot of projects advocate huge expenditures and recommend techniques and technologies, which are not feasible for Pakistan. There is an urgent need to develop local standards and practices based on research on indigenous conditions. It is also necessary to train experts in core water issues and use their knowledge base to develop a research network. Currently, some research institutions are contributing such as PCRWR, IWMI, International Water Logging and Salinity Research Institute (IWASRI), Irrigation Research Institute (IRI), PARC etc. However, access to reliable research and information from these agencies is often difficult and needs to be simplified.

Community Awareness and Mobilization

According to World Bank, user participation in water sector projects increases efficiency, equity and cost recovery¹¹⁵. An effective water management plan cannot be implemented without the education, awareness and active participation of the community. The community has to be involved in planning and developing of the strategy and then actually implementing it in the local settings to promote sense of ownership. Who are the main stakeholders (large landowners, small farmers, urban citizens, sugar mill owners, industrial leaders, the army and religious leaders), how they are affected, their current perception and their potential impact on the outcome of any water management initiative are important questions which should be asked before any project. Usually, a small minority of the population (whose interests are threatened by change) is hostile to any proposed change, a smaller group will approve and rest of the population will sit on the fence, to see which way the wind blows. But experience shows that it is generally possible to identify and mobilize 20% of the population from amongst the last two groups to actively lead, support and implement the changes, and influence the fence sitters. The group who will initially support the change will include innovative farmers, advocates for the poor, educated religious leaders and distinguished academics, for example, at the PCRWR.

While awareness campaigns for efficient use of water resources are crucial, low literacy rate is a hindrance. The adult literacy rate in Pakistan is only 43%, far below the average even in developing countries (74%). Many efforts to encourage more on-farm efficient water practices fail because farmers are illiterate. Increasing literacy will also help Pakistan reduce the birthrate. Moreover, crucial to the awareness campaigns will be reward and recognition systems that motivate people. These can include charging less for lesser consumption. Farmers with innovative, water-saving ideas can receive the gift of food/trickle irrigation

¹¹⁵ World Bank website. URL <http://www.worldbank.org/wbi/sourcebook/sba206.htm>

systems or sprinklers. Additionally, research on water related projects should also benefit from the local knowledge and thus have to involve communities more closely. Project planning and execution in water sector needs to be based on rigorous research and must include suggestions and convenience of various stakeholders.

**Towards A Joint Agenda
for Aid Effectiveness in Pakistan**¹¹⁶

1. Introduction

Foreign assistance is playing an important role in Pakistan's development strategy. The provision of additional funding from external sources enables the Government of Pakistan to increase its development spending, while technical cooperation activities can help to overcome identified capacity gaps, which hinder effective service delivery at federal and provincial level.

However, in order to ensure that foreign aid adds value and is complementary to national development efforts, it needs to be aligned with national priorities and procedures. Too often, large unproductive costs and misalignment of aid have resulted in missed opportunities to improve people's lives by using all resources better. The effective use of aid, the case for more aid, and demonstrable results on the ground are interrelated and intertwined with key roles both, the Government of Pakistan and its development partners, need to play.

The Government of Pakistan recognizes its responsibility for ensuring development effectiveness, as well as for providing a corresponding enabling environment for all actors involved in development activities. However, lasting improvements in the delivery of foreign assistance can only be achieved through active collaboration of all development partners, in line with the principles outlined in the Paris Declaration on Aid Effectiveness. Since the Pakistan Development Forum in 2006, the Government of Pakistan, in collaboration with its development partners, has intensified its efforts to foster the implementation of the Declaration. This paper intends to take stock of respective progress made and outlines plans to advance the national aid effectiveness agenda.

This paper is a working document. It is neither meant to be prescriptive nor considered to be all inclusive. The main purpose of this paper is to stimulate discussions between the Government of Pakistan and its development partners regarding possible options to increase development effectiveness in Pakistan. The paper does not define a final strategy of the Government of Pakistan.

2. Key Issues Influencing Aid Effectiveness

There is an ongoing discourse at global and regional levels to foster development. In the context of Pakistan, this discourse has featured more prominently on the agenda of development partners. Various efforts have been undertaken to identify and document the main factors that determine aid relationships in Pakistan and that influence the overall aid management architecture in this country. For example, a group of development partners commissioned a paper on aid effectiveness in Pakistan for the Pakistan Development Forum in 2006, the Government of Pakistan launched the Paris Declaration Baseline Survey in the same year and individual development agencies, including the United Nations, have started to review their internal working procedures to identify ways to improve aid effectiveness.

**Discussion Paper for the
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¹¹⁶ **Disclaimer:** This Discussion Paper has been prepared for the Economic Affairs Division (EAD) to inform the discussions during for the Session on Aid Effectiveness within the course of the Pakistan Development Forum 2007. However, the content of this paper should not be construed as the official position of the Government of Pakistan or its related organizations and agencies.

These different types of reviews and assessments brought a number of issues and challenges to light that influence the effective planning, management and use of aid and thereby the effectiveness of development efforts overall. Some of the key issues can be summarized under the following headings:

- *Effective Government leadership:* Development partners often refer to a lack of leadership by Government institutions. While it is fair to say that some Government authorities, especially at District and Provincial levels, lack the required capacity to effectively plan and lead on development efforts, it should also be noted that many foreign-funded projects and programmes are being conducted independently of Government institutions, which does not only jeopardize the sustainability of these initiatives, but also undermines effective Government leadership.
- *Alignment:* Foreign assistance is not entirely aligned with national development priorities and procedures. Multiple donors pursue various individual initiatives, which do not result in coherent approaches at sector level. The lack of alignment is to some extent caused by too broadly formulated strategies in some sectors, which indicates that respective planning capacities need to be enhanced.
- *Harmonization:* Almost all development partners use individual financial management, procurement and reporting procedures, which are often not harmonized with one another. In addition, there is a need to further harmonize implementation mechanisms across provinces.
- *Coordination:* One of the biggest challenges derives from insufficient coordination of development assistance, which can be found at various levels. On the one hand, development partners commonly complain about weak coordination within and among Government institutions and seem to be uncertain regarding the respective roles and responsibilities of Federal and Provincial Authorities within the programme cycle. On the other hand, the findings of the Paris Declaration Survey reveal a severe lack of coordinated technical cooperation efforts by development partners. Further, there are only limited examples of programme-based approaches and the number of coordinated donor missions and coordinated country analytical work is comparably small.
- *Managing for results:* The focus on achieving pre-defined development results needs to be increased. In this context, harmonized results-oriented frameworks need to be developed, which facilitate monitoring of progress towards achieving national and sectoral development objectives.
- *Transaction costs:* The low level of harmonization of implementation mechanisms and the inadequate coordination, combined with a recognizable high number of foreign-aided projects in certain sectors results in high transaction costs for the Government of Pakistan. A detailed assessment of the kinds and amount of transaction costs is required in order to fully understand the respective dimensions in the context of Pakistan and to develop appropriate measures to reduce these costs.
- *Information on aid flows:* The important role of the Government in shaping how aid is used can only be played if Government authorities have access to timely and comprehensive information on all planned and ongoing aid. Currently, there are no harmonized procedures for reporting on planned and actual commitments and disbursements. Multiple donors are using various different formats and timelines to report on their development assistance. This makes it very difficult for the Government to develop a comprehensive overview of aid flows, which affects its ability to allocate external resources in line with the domestic budget.

3. Aid Effectiveness Initiatives in Pakistan

In close collaboration with its development partners, the Government of Pakistan has recently started different initiatives to make concrete progress towards increasing aid effectiveness in Pakistan, in line with the commitments made in Paris.

- *Establishment of a joint GoP-Partner Aid Effectiveness Steering Committee.* The joint Steering Committee is chaired by the State Minister of the Economic Affairs Division and consists of Government officials, as well as representatives from ADB, DFID, the Embassy of Japan, UNDP, USAID and WB. This Committee has been set up to discuss and spearhead joint initiatives to increase aid effectiveness in Pakistan. In order to make maximum use out of this dialogue mechanism, the mandate, terms of reference, composition and frequency of meetings needs to be reviewed, especially in the light of the joint aid effectiveness agenda brought forward in this paper.
- *Establishment of a Donor Coordination Cell,* as a dedicated unit within EAD responsible for leading on issues related to implementing the Paris Declaration at country level and foster overall aid effectiveness. In the light of the increasing number of activities to strengthen the Government's aid management capacities, as well as to increase the overall effectiveness of foreign assistance, the mandate and staffing requirements of the Donor Coordination Cell will need to be reviewed.
- *Establishment of three joint working groups,* which are meant to develop actionable recommendations on how to make progress in areas of particular concern. These groups are chaired by the responsible Government ministry and co-chaired by a development partner. Directly reflecting Government priorities, the following working groups have been established:
 - *Financial Management & Procurement Harmonization & Country Systems Strengthening,* which is co-chaired by the World Bank;
 - *Capacity Development and Sector-Wide Approaches,* which is co-chaired by the Asian Development Bank;
 - *Harmonizing Monitoring and Evaluation Systems,* which is co-chaired by the UK Department for International Development.

Most working groups have meanwhile developed their terms of reference. Some have started procedures to recruit suitable consultants for the required assessments and analyses. It is expected that all groups produce first tangible results within this year.

- *Set-up of an aid information management system.* A prerequisite for the effective planning, allocation and management of foreign assistance is the timely availability of accurate information on aid flows, including commitments and disbursements by sector and geographic location. In this respect, a Development Assistance Database was established by the Economic Affairs Division, as a first step towards harmonized reporting and a standardized information sharing process. However, the effectiveness of the system is challenged by the fact that some development partners are reluctant to provide information through the system, despite corresponding commitments made in Paris in 2005.
- *Implementation of the Paris Declaration Baseline Survey.* In order to collect concrete data describing how foreign aid is provided and managed, the Government of Pakistan has conducted the OECD DAC Baseline Survey on Monitoring the Paris Declaration on Aid Effectiveness. The survey is meant to generate a broad-based dialogue at country level on how to make aid more effective and should further contribute to building a common understanding on key concepts applied to increase the effectiveness of aid, in order to achieve development results.

The survey has led to the collection of basic data, which helps drawing a picture of the overall aid management architecture. It disclosed that a common understanding of main aid management concepts, as well as regarding definitions of key terms does not exist among all development

partners. Further, the survey brought to light that development partners are very divided among themselves regarding their interpretation and implementation of the Paris Declaration. In order to make maximum use of the survey exercise, it is essential to continue the joint dialogue about its major findings and to define measurable local targets for improving identified shortcomings.

4. Towards a Joint Agenda to Increase Aid Effectiveness

The Government of Pakistan stands firmly to the commitments captured in the Paris Declaration. It recognizes a need for enhancing its efforts to facilitate the implementation of the Declaration in the context of the political, economical and social context of Pakistan. Against the background of the existing challenges outlined above and with a view to further advance ongoing initiatives, the Government intends to take concrete steps to develop and implement a Joint Aid Effectiveness Agenda for Pakistan. This agenda is supposed to combine individual measures taken or to be taken by the Government and its development partners, as well as ongoing and future joint initiatives under one common strategic framework. This will ensure complementarities among these initiatives and provide for a maximum amount of synergies between them.

A central element of the joint agenda is increased *Collective Dialogue* between concerned Government institutions and development partners, which has been identified as a critical driver to make progress on many of the issues outlined above.

Another key element of this agenda is the formulation of a *Foreign Assistance Policy Framework*, which will guide the provision, allocation and management of external aid and define respective roles and responsibilities.

As a means to support the consolidation and implementation of the joint agenda, the Government plans to pursue the development of an *Action Plan* for Aid Effectiveness.

(1) Collective Dialogue

Weak coordination at various levels has been identified as one of the major challenges for effective planning, allocation and management of foreign assistance. While PRSP and MTFD play a key role in outlining national development priorities, continuous dialogue between the Government and its development partners is required, in order to reach a mutual understanding on how exactly each partner can best support national development efforts in a coordinated manner.

Building on positive experiences with collective dialogue mechanisms in the education sector, as well as lessons learnt in the context of the relief and recovery phase following the 2005 earthquake, it is foreseen to establish a limited number of joint GoP-Partner Working Groups around key sectors and themes, which reflect priorities identified in PRSP and MTFD. Such working groups would be chaired by the concerned line ministries, while a selected development partner would play the role as lead facilitator.

It is envisioned that this kind of arrangement will increase alignment of foreign assistance with improved sectoral plans, as well as contribute to more coordination and rationalization of external support. Further, it is supposed to enhance coordinated technical cooperation efforts within the respective sector. It will be critical to avoid a too heavy emphasis on structures and procedures, which have proven to deviate the focus away from substantive matters. Individual groups need enough flexibility to define their terms of reference and work plans. Members of these technical working groups need to be at the appropriate level.

(2) Foreign Assistance Policy Framework

The Government of Pakistan is preparing national plans at periodic intervals for the economic and social development of the country. Further, it has established a number of instruments, mechanisms and procedures, together with underlying rules and regulations, which support and define the planning, processing and reporting on development projects. Despite these arrangements, uncertainties regarding the respective roles and responsibilities of Federal and Provincial Authorities within the programme cycle occur. In this respect, the Government identified a need for reviewing existing rules and regulations that govern the planning, provision, allocation and management of foreign assistance and to develop a *Foreign Assistance Policy Framework*. The respective document will indicate the Government's preferences and priorities regarding assistance modalities, areas of support, reporting modalities, etc.

The different ongoing and future initiatives to foster aid effectiveness are regarded as interlinked and as parts of a broader effort to increase aid effectiveness. It is foreseen that many of these initiatives will provide concrete inputs into the development of the Foreign Assistance Policy Framework. The formulation of the policy document will be led by the Government of Pakistan and supported by broad-based dialogue, involving different tiers of the Government, as well as development partners.

(3) Aid Effectiveness Action Plan

While essential steps have already been taken to address some of the issues that influence aid effectiveness in Pakistan, there is a risk that these individual initiatives lose their focus and do not complement each other in a mutual re-enforcing way. In order to consolidate ongoing and future initiatives to increase aid effectiveness in Pakistan in a coherent framework and give them a strategic direction, the Government seeks support from its partners regarding the development and implementation of an Aid Effectiveness Action Plan. Such a plan is meant to serve as common framework that outlines overall objectives, expected outputs and concrete actions with adjoined timelines and assigned responsibilities, with regard to increasing aid effectiveness in Pakistan. It will guide all ongoing efforts and those to be taken in future to increase the effectiveness of foreign assistance.

After the Pakistan Development Forum, the Economic Affairs Division plans to organize a seminar, in order to discuss concrete next steps to finalize and implement the Aid Effectiveness Action Plan.

While individual partners or Government institutions would be responsible for specific outputs, it is foreseen that the Aid Effectiveness Steering Committee will oversee the implementation of the plan as a whole.