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Joint Staff Assessment of the Poverty Reduction Strategy Paper

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and the International Monetary Fund (IMF)

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I. OVERVIEW

1. **The full Poverty Reduction Strategy Paper (PRSP) for Pakistan entitled “Accelerating Economic Growth and Reducing Poverty: The Road Ahead” builds on the strategy articulated in the Interim Poverty Reduction Strategy Paper (I-PRSP) presented to the Boards of IDA and IMF in December 2001.** The PRSP lays out a comprehensive and adequate development agenda, which needs to be complemented with a more specific implementation plan. Preparation of the full PRSP was delayed until after the 2002 elections and ensuing political transition to ensure full ownership of the elected government.

2. **The government of Pakistan has established a strong track record in implementing the reforms envisaged in the I-PRSP** despite difficult macroeconomic and geopolitical conditions and the transition from a military to an elected government. Key reform components, which emphasize the role of the private sector, include successful macroeconomic stabilization, trade, financial sector and corporate governance reforms, as well as re-orientation of public expenditures towards education, health, and other expenditures prioritized in the I-PRSP. The government has also made tangible progress in costing priority reforms in the social sectors and monitoring key poverty and human development indicators. Governance reforms, including tax administration, financial management, and devolution of power to local governments were launched to improve the responsiveness and effectiveness of government. These achievements are accurately presented in the PRSP.

3. **The PRSP consultation process involved provinces, sectoral ministries,** and efforts were made to reach the poor and civil society at the grass roots level. Consultations were also held with the newly elected district governments.

4. **In moving forward, several remaining challenges need to be addressed.** The cross-cutting challenge is to draft an explicit and prioritized roadmap of reforms and policy actions envisaged in the medium term with a clear timeline. Specific policy challenges include: (i) strengthening the financial performance of the power sector to reduce its large budgetary cost while improving reliability and access to electricity; (ii) successfully implementing administrative and fiscal devolution—including capacity building at lower tiers of government for enhancing the effectiveness of service delivery; (iii) introducing a broader rural strategy to improve agricultural productivity, expand non-farm rural employment and reduce rural poverty; and (iv) implementing the Core Welfare Indicators Questionnaire (CWIQ) survey and finalizing broader institutional arrangements for monitoring and providing timely feedback into the policy process.

II. COUNTRY OWNERSHIP AND PARTICIPATION

5. **The broad participatory approach that was initiated during the I-PRSP process underpinned the development of the full PRSP.** Following the discussion of the I-PRSP at the World Bank and IMF Boards and after the elections in October 2002, consultations were

held in all provinces. Each province was encouraged to produce its own PRSP, incorporating consultations with the newly elected district governments. A process of consultation was also conducted, including symposia, seminars, and workshops to discuss the various elements of the PRSP strategy. These focused on the analytical building blocks of the PRSP, such as poverty measurement issues, baselines, and sources for various social indicators, as well as the preparation of strategies in education, health, employment, and pro-poor growth policies. The results are summarized in the PRSP section on regional perspectives.

6. **Partnership with nongovernmental organizations, primarily the Rural Support Program Network (RSPN), yielded rich consultations at the grass roots level.** The RSPN undertook community-level consultations in 49 districts of the country, encompassing 120 communities, and identified key non-income factors affecting poverty and vulnerability, particularly in remote rural areas. A participatory poverty assessment was conducted in 54 field sites across all provinces, the Federally Administered Tribal Areas and the Northern Areas. The insights from these exercises have also contributed to the strategy articulated in the PRSP. The donor community was consulted during preparation of the full PRSP—a summary version of the PRSP was discussed at the Pakistan Development Forum in June 2003.

7. **Following the major political transition to elected assemblies at the federal and provincial levels in November 2002, a key challenge remains in getting full Parliamentary support for the PRSP process.** To this end, before finalization, a draft PRSP was submitted to the Senate and the National Assembly, followed by a one-day workshop with parliamentarians on process and contents of the PRSP. The PRSP notes that Parliament's approval of the national budget in June 2003 represents an implicit endorsement of the broad reforms articulated in the PRSP. An important challenge in the coming months will be to strengthen the involvement of Parliament in the PRSP process, starting with its full endorsement of the next annual PRSP Progress Report.

III. POVERTY DIAGNOSTICS

8. **The PRSP presents an informative description of the trends and spatial patterns of poverty.** The analysis of diagnostics is grounded in evidence from the last two rounds of the Pakistan Integrated Household Survey/PIHS (1998–99 and 2001–02), which has been institutionalized as the primary source for poverty and human development data. The poverty estimates in the PRSP use the newly developed official poverty line for Pakistan, and establish baseline figures from the 1998–99 PIHS round, when the survey was revised to combine consumption and social/demographic modules.

9. **The diagnostics identify links between poverty and employment patterns, while highlighting regional and provincial differences.** In view of the growth-based strategy outlined in the PRSP, the staffs particularly welcome the exploration of linkages between poverty and employment. The focus on human development indicators in the diagnostics highlights the need to expand access to and improve governance of service delivery. Given that vulnerability is a key concern in Pakistan, the staffs also welcome the focus on transitory

poverty and its clear links to the fourth pillar of the strategy, namely targeting the poor and the vulnerable.

10. **There are areas where the diagnostics could have been linked better to the poverty reduction strategy outlined in the document.** While the links between employment and poverty are stressed, the diagnostics do not clearly identify sectors where growth and employment generation would have the greatest impact on poverty. The links between livestock and crop farming and rural poverty should be explored more fully to underpin the stated objective of improving agricultural productivity. While the measures on housing finance emphasize the growth-enhancing aspects of housing construction, its role in reducing vulnerability could have been shown more clearly through relevant poverty diagnostics. The staffs are of the view that future analytical work on these issues will be important for fine-tuning and prioritizing within the broad poverty reduction strategy outlined in this document.

11. **The analysis of gender issues is much stronger than in the I-PRSP.** Nevertheless, more insights into the gender dimensions of labor market participation and unemployment would have provided linkages with some of the key elements of the gender and empowerment strategy. Going forward, the staffs are of the view that analytical work focusing on gender aspects along various economic and social dimensions will be essential for implementing the broad gender strategy.

12. **While encouraging progress has been made on resolving the methodological issues in measuring poverty, the PRSP recognizes that work remains to be done in this area.** A government appointed technical committee has evaluated and resolved the survey-related questions noted in the Joint Staff Assessment (JSA) for the PRSP Preparation Status Report (2003). An official poverty line has been defined in food calorific terms. Still, a number of questions—including adjustment of the poverty line over time for price changes and the choice of equivalence weights—are still subject to debate. The provisional poverty numbers reported in the PRSP may be revised upon resolution of these issues. It is expected that, based on technical analysis, consensus will be reached on these methodological issues over the next year.

IV. THE POVERTY REDUCTION STRATEGY

13. The government has prepared a broad-based strategy for addressing poverty, including accelerated human development, better governance, and reduced vulnerability, which continues the economic program first articulated in the fall of 1999. The strategy correctly emphasizes promoting sustainable growth as the main vehicle for poverty reduction. The macroeconomic and expenditure frameworks embodied in the PRSP are ambitious but achievable with the continuation of reforms and in the absence of major adverse political and security shocks. The projections present a promising start in aligning government resources to address the challenges ahead. There have been major accomplishments in implementing and refining policies identified as priority areas in the

I-PRSP. Looking ahead, a key challenge will be to effectively manage the implementation of the strategy's ambitious and diverse policy agenda.

A. Targets, Indicators, and Monitoring

14. The PRSP outlines a framework for monitoring expenditures and outcomes, which includes the indicators to be monitored, identification of relevant data sources, and institutional arrangements for the monitoring system, and for providing feedback to policymakers.

15. **Significant progress has been made since the I-PRSP in identifying the indicators that are to be monitored.** A collaborative process, involving federal and provincial ministries, donors, and civil society, conducted during 2002, resulted in the selection of appropriate monitorable intermediate and outcome indicators. Sources for these indicators include existing data sources, as well as planned annual surveys for tracking intermediate indicators related to access, usage, and satisfaction with public services at the district level. In this regard, the staffs welcome the increasing reliance on third party data sources to minimize the reliability problems associated with administrative data reported by implementing agencies. On the expenditure side, a quarterly tracking and reporting system for poverty-related expenditures has been established.

16. **The PRSP indicates that work remains to be done in the key areas of developing consistent baselines and targets for many indicators related to the Millennium Development Goals (MDGs).** The targeted improvements are in some cases very ambitious—e.g. enrollments, infant and child mortality, and proportion of fully immunized children—raising some concerns about the realism of the PRSP's targets under the current baseline. Baseline figures drawn from administrative reporting systems appear to be high compared to household survey results, suggesting a need to identify a reliable data source for tracking progress in these areas. Efforts to develop consensus on the baseline for critical education indicators are still underway; this requires urgent resolution as it has significant implications for targets and resource requirements. Staffs believe that for many of these indicators, the PIHS represents a reliable source, especially since it is representative at both the national and provincial levels.

17. **The PRSP reports encouraging progress in planning and implementing a modified CWIQ survey to track intermediate indicators.** A pilot has been successfully completed, and the first full survey is planned for March 2005, although its results will not be available in time for the 2004/05 budget. Institutionalizing this survey on an annual cycle will provide a valuable database for tracking the impact of reforms at the district level to provide timely feedback for policy implementation that is expected to occur to a large degree at the district level as devolution takes hold.

18. **The effectiveness of a monitoring system—and its impact on the policy process—critically depends on the institutional arrangements and the capacity of these institutions.** Progressing from the I-PRSP, the PRSP lays out an institutional setup in more

concrete terms, specifying a general mechanism for tracking and reporting outcomes, coordinated by the federal PRSP Secretariat. There is, however, still a lack of clarity on some key specifics, such as the mechanisms through which the data and reports generated by the monitoring institutions would provide timely feedback into the policy process. **While the document identifies four key areas where capacity has to be developed at the Secretariat and within various levels of government, there is no clear plan on how this need will be addressed.** Specifically, the sustainability of the monitoring system, including the CWIQ, will depend critically on the technical and financial capacity of the Federal Bureau of Statistics (FBS) to effectively conduct complex surveys, and its ability to function as an autonomous organization. The staffs recommend that the authorities develop a plan for enhancing capacity of the FBS and provide for its autonomy in order to enhance its role as a credible source of data.

B. Macroeconomic Framework and Structural Agenda

19. **The PRSP presents an ambitious framework for accelerating growth and maintaining macroeconomic stability.** Generating rapid growth of 6 percent or more per year as envisaged in the PRSP will require a substantial increase in private sector investment and the continued expansion of private sector activity; this will only materialize with further improvements in the perception of domestic and regional stability and the investment climate. Public sector investment will also have to play a supportive role, for example, by addressing infrastructure bottlenecks. The projections envisage manufacturing to continue growing at a high rate, while growth in agriculture and other sectors would accelerate. The authorities' investment program in the agricultural sector, if combined with reduced public intervention in agricultural output markets, is expected to yield productivity gains that would support the acceleration of growth in this sector and contribute to addressing the large problem of rural poverty. With investment increasing and national savings falling somewhat relative to GDP from the exceptionally high level of 2002/03, the current account would show a small deficit towards the end of the forecast period which seems appropriate given Pakistan's development needs and would be consistent with a sustainable external position.

20. **The medium-term fiscal framework balances the need for increased social- and poverty-related spending and reduction of the public debt burden.** The overall deficit excluding grants is contained between 3½ and 4 percent of GDP, and total public debt is projected to fall to 66 percent of GDP; external public debt would fall to 29 percent of GDP by 2007/08. This debt reduction path is somewhat more ambitious than required under the draft fiscal responsibility law and would result in a continued reduction of fiscal and particularly external vulnerabilities. Within this framework, social- and poverty-related spending is raised by 1.4 percentage points to 6.8 percent of GDP in 2007/08, and PSDP spending is raised by 1.1 percentage points to 5.5 percent of GDP in 2007/08, while overall expenditure stays flat as a percent of GDP. The fiscal space for this is created by an increase in domestic revenue, lower interest expenditures, and compressing other expenditures, notably transfers to public sector enterprises, in particular the power sector.

21. **There are downside risks to the fiscal outlook, but also some potential for stronger revenue performance.** There are two main downside risks: (i) the implied expenditure compression is ambitious, in particular for reducing transfers to the power sector, though it would certainly be welcome; and (ii) nontax revenue may not reach projections if dividends fall on account of privatization. However, the fiscal framework could have been more ambitious on tax revenue, assuming steadfast and swift implementation of the government's strong program of tax administration reforms, a broadening of the taxpayer base, extending the general sales tax further into the service sector, and withdrawing remaining exemptions. If tax revenue were to exceed the authorities expectations, this could provide some offset for the downside risks. Any additional fiscal space could be used to further raise PRSP expenditures if institutional capacity to absorb additional spending is enhanced. Alternatively, a more front loaded time path for the reduction of debt would reduce vulnerabilities early on, given the still very high level of public indebtedness. In this regard, the staffs note that the fiscal framework is viewed as indicative in the PRSP and more ambitious revenue targets can be set in the context of individual budgets.

22. **The authorities' financing strategy relies largely on domestic sources.** Domestic financing requirements to cover the overall deficit including grants are about 1½ to 2 percent of GDP over the forecast horizon, in line with levels realized in the past. However, if yields on National Savings Schemes instruments are better aligned with market rates, as they should be, this source may be less forthcoming and the government would have to rely more on treasury bill and bond financing (or privatization receipts). Progress on developing the domestic capital markets will be instrumental for providing sufficient resources to the government without crowding out the private sector. In light of the comfortable reserves position, the authorities should continue to prepay expensive external debt of around US\$1 billion annually, as planned, to lower interest expenditure. At the same time, the government is also returning to the market with a bond issue in early 2004. The issue is mainly intended to ensure Pakistan's presence in major markets and indices, and staffs support the authorities' plans.

23. **Compared with the I-PRSP, the PRSP presents budget allocations that are better aligned with the desired improvement in social indicators.** Still, further increases might be desirable, if tangible improvements in governance and expenditure management are realized to ensure effective utilization of additional resources while respecting the targets for reducing the overall deficits. The staffs welcome that the increase in the share of priority spending envisaged in the I-PRSP has been broadly achieved. Going forward, the share of PRSP allocations in total budget (and GDP) is projected to increase from 26 percent (5.4 percent of GDP) in FY 2004 to 32 percent (6.8 percent) in FY 2008. **Nevertheless, although these allocations underscore the government's resolve to provide additional resources for poverty alleviation, many improvements will be required in budget execution and financial accountability procedures and practices to translate these allocations into effective expenditures.** If ongoing efforts in this regard are accelerated and combined with continued improvements in the speed of releases to provinces and districts, service delivery could be improved considerably. The PRSP also refers to forthcoming improvements in the legal framework for public procurement at the federal level which

would improve the transparency, cost effectiveness, and quality of public expenditures. An open issue is how the federal government can assure the level and composition of expenditures as subnational levels take more responsibility for policy and service delivery and receive more resources under the expected new National Finance Commission award.

24. **The lack of a medium-term expenditure framework (MTEF) has made the costing of PRSP targets difficult, and progress in this area constitutes an important challenge.** The federal government has started a sector by sector costing exercise. This, however, is so far limited to just two sectors—education, and health and population—and to the federal level which constitutes only 30 percent of the total sectoral expenditure. The exercise needs to incorporate more sectors to facilitate overall budget planning and allocations in accordance with priorities; it would also benefit from a more consultative process involving line ministries and sub-national governments, given that a large share of expenditures actually occur at the sub-national level. In general, improving expenditure management would require a comprehensive process, both at the federal and provincial levels to build greater capacity for budget formulation in sectoral ministries, establish sectoral budget ceilings consistent with the aggregate MTEF, and integrate the development and recurrent budget. In addition, expenditure implementation could be improved by increasing predictability for spending agencies by providing clear budget allocation for the year and a steady flow of resources to carry out their tasks.

25. **Pakistan has significantly liberalized its trade regime, but faces the challenge of continuing this process.** The PRSP acknowledges that continued efforts to improve the competitiveness of the economy, in particular tackling infrastructure constraints and the enabling business environment, are essential to reap the rewards of liberalization and to sustain export growth. Measures to further liberalize the trade regime would also be welcome, including reducing protective tariffs (above the top rate of 25 percent) for some industries like oilseeds and automobiles, lowering the maximum tariff rate and tariff peaks, and converting specific into ‘ad valorem’ tariffs. The South Asia Free Trade Agreement (SAFTA), signed after the PRSP was issued, is a historic development. Working with SAARC countries to implement the SAFTA agreement is a key medium-term challenge with potentially very important benefits—even beyond trade—to be expected from regional integration.

26. **A key challenge in the power sector, vital to the PRSP’s growth aspirations, is to improve service while reducing its large reliance on budget transfers to cover operating losses and finance essential investments.** The PRSP highlights existing inefficiencies and issues in the power sector, addressing which will require improving the utilities’ performance, establishing a transparent regulatory framework, and strengthening governance and oversight. The PRSP also recognizes the importance of ensuring reliable power for households and businesses while protecting the poor from extreme fluctuations in electricity prices through targeted subsidies for low-income households. To this end, the government is committed to formulate a Financial Recovery Plan which is directed towards improving governance and accountability—including accelerated privatization, implementing aggressive measures to reduce costs, reforming tariff and subsidy policies, and establishing a

policy framework which ensures that the investments required in the power sector will be fully funded. Implementation of this plan is expected to place the sector on a path toward financial viability and expand access and increase the reliability of power supplies which are necessary to sustain rapid economic growth. **The challenge for the government is to ensure that the Financial Recovery Plan includes concrete and monitorable actions with clear responsibilities** for implementation and oversight. In the short-run, the government will need to implement National Electric Power Regulatory Authority determined tariff adjustments in a timely manner to safeguard the fiscal space needed for increased PRSP spending.

27. **In light of the expected key role of private sector activity in generating economic growth, the PRSP adequately stresses the importance of investment climate reforms for supporting the growth agenda.** Considerable improvements in the investment climate have taken place in the past four years. The PRSP identifies the key reforms necessary to reduce the cost of doing business, namely deregulation, labor market reform, investment policy, improvements in access to finance, delivery of services such as power, irrigation and telecommunications, several of which are already underway. The government has also established various regulatory authorities such as the National Electric Power Regulatory Authority and the Pakistan Telecommunication Authority. To enhance competitiveness and transparency, reforms are also envisaged in the antitrust and financial market regulatory bodies. The PRSP's emphasis on small and medium enterprise development is welcome from the perspective of broad-based economic growth and employment generation/poverty reduction. However, the strategy would have benefited from a more systematic analysis of transport bottlenecks and specific policies for their resolution. Looking ahead, there is a need to tackle the restructuring of key large scale enterprises (e.g. fertilizer, sugar, cement, steel, etc.), which is critical for enhancing international competitiveness and exports.

28. **The emphasis placed on improving governance through civil service reform is welcome.** The PRSP highlights the key issues: a flatter structure, merit-based recruitment and promotion criteria, performance based compensation, and incentives to improve innovation. The commitment to further implement pay and pensions reform is welcome. There is also an ambitious proposal to restructure the civil services by creating five new services, including the National Executive Service, in order to break free of some of the structural rigidities resulting from the current cadre system. The management of staff at the district level through the creation of a District Civil Service is a possibility raised in the PRSP.

29. **Since the I-PRSP, the government has made significant progress in implementing its devolution plan.** Devolution is envisaged to change the relationship between decision-makers, service providers, and clients in fundamental ways to improve access to and quality of service delivery. Political devolution has been completed, and local governments are now headed by elected officials. A good start has also been made on establishing mechanisms for effective fiscal devolution.

30. **However, many challenges remain to ensure that devolution will yield the expected improvement in access to and quality of service delivery.** It is encouraging to see that the PRSP includes a clear commitment to transfer an increased share of the fiscal

space generated at the federal level to provincial governments, as is the related undertaking to restructure the federal government and transfer functions to the provinces. **The staffs hope that provincial governments will also pass on the additional transfers to lower levels of government through the Provincial Finance Commission mechanism.** The PRSP does not clearly address the challenges of implementing fiscal transfers and devolving responsibility for services, such as water and sanitation, and understates the need for creating incentives for provinces and districts to generate own-source revenue, as well as to design a reliable system of allocating revenues from some of the more buoyant taxes to the provinces and districts. In this regard, the staffs look forward to the expansion in the coverage of the General Sales Tax on services. The direct election of zila and tehsil nazims, referred to in the PRSP, can enhance their autonomy, but will need to be bolstered by greater administrative devolution so that employees are more clearly accountable to the districts and not the provinces.

31. **In addition to the federal government, provincial and local governments now have increased responsibility for achievement of the development and poverty reduction goals.** Achieving these goals will need the clear alignment of roles, responsibilities, and accountabilities between the different tiers of government. This can only become possible when the political process is backed by administrative devolution, supported by resource allocation mechanisms that are created through the fiscal devolution process like the upcoming National and Provincial Finance Commissions awards.

C. Sectoral Policies

32. The poverty reduction strategy outlined in the PRSP incorporates a number of sectoral reforms and initiatives. These include financial sector reforms, sectoral strategies for rural development, education, health and urban municipalities, and programs for targeted intervention to reduce vulnerability.

33. **Pakistan has implemented significant reforms in the financial sector.** The PRSP describes these reforms and clearly lays out the future vision and government's strategy for the sector. The staffs look forward to the completion of the government's restructuring and privatization program of public sector banks. Habib Bank Limited's imminent privatization should now be followed by privatization of the National Bank of Pakistan. In addition, with the improved regulatory framework, more and more commercial banks are providing loans for small and medium enterprise, housing, and agriculture financing. As these institutions develop further, it would be important to discontinue government financing for these purposes. An outstanding challenge in the financial sector is to design a mechanism for phasing out the remaining special purpose institutions, either through privatization or closure. It is also important that the regulators of financial markets continue to provide an environment that encourages product development and innovation while emphasizing risk management. The forthcoming Financial Sector Assessment Program (FSAP) will be useful in developing the financial sector reform program further. Staffs look forward to seeing the recommendations from the FSAP reflected in the first PRSP Progress Report.

34. **The PRSP emphasizes improving productivity and rural infrastructure as necessary conditions for achieving more rapid rural growth and poverty reduction, given that two-thirds of Pakistan's population is rural.** However, more attention should be paid to the role of markets. In addition to liberalizing the access to international markets, public sector intervention in domestic markets of major commodities, particularly wheat, need to be phased out. While the PRSP acknowledges the importance of the livestock sector, there is a need to outline more specific public policy instruments for livestock development and clearer delineation of public roles (regulatory, phyto-sanitary, public health) and private sector roles (animal health, feed, processing).

35. **The thrust of the discussion of water issues and of linkages to the power sector is sound.** However, the plan lacks specifics on water demand management policy reforms and action plans. In particular, there is no discussion of surface water pricing and cost recovery, which are essential to rationalize water use. On water conservation, the PRSP overemphasizes civil works (mostly canal and water course lining), while not mentioning wasteful irrigation practices (particularly for rice and sugar cane), and the lack of incentives to conserve water and maintain the irrigation infrastructure. The medium to long-term challenge is how to translate into action the stated objectives of decentralization, participation and management transfer of the tertiary system to communities.

36. **Though accelerated distribution of state-owned land to small farmers is a positive step, larger-scale programs would be necessary to substantially increase small farmer incomes and reduce poverty.** The PRSP rightly emphasizes the need for well functioning factor markets. Nevertheless, on land issues, the strategy seems to focus only on the distribution of state lands to small farmers, while excluding broader issues of access to land. Greater clarity is needed in land distribution policy, taking into account the tradeoff between small farmer programs and those that involve leasing out public land for corporate agricultural farming. There also remains a question as to whether the costs of public investments and other incentives for corporate farming are economically and socially justifiable.

37. **The strategy on education is well articulated with a clear recognition of core sector and cross sectoral issues, the need for increased investment, and appropriate linkages with MDGs with a focus on reducing gender disparities.** The national Education Sector Reform and the Education For All action plans form the centerpiece of the PRSP education strategy. While these plans have a major significance in outlining the strategic framework and the reform agenda, the provincial programs that represent over 90 percent of the country's education expenditures merit more attention than what has been articulated. The inclusion of provincial education program priorities in the PRSP chapter on regional perspectives is welcome, but could have been better integrated with the overall strategy—given their key role in carrying the national policy priorities forward.

38. **Progress towards education targets and goals may require additional resources and, more importantly, improvements in the efficiency and quality of spending,** which in turn is linked to the success of devolution—the fundamental area of reform in service

delivery. Further work in costing of education targets would help align the targets better to expenditures, and establish more credible projections at the provincial level. The PRSP would have benefited from greater clarity about the role of the devolved structure in implementing the education strategy, and on the related issue of the kind of mechanisms required to transmit policy priorities from higher to lower levels of government. Although one innovation in this area is noted, namely the terms of partnership agreements to provide additional financing to districts in Punjab, more such instruments to leverage national and provincial policies for reform implementation would be needed.

39. The potential for public-private partnerships in education, given the rapid expansion of private schools, is significant in Pakistan. **The PRSP acknowledges the potential gains from such partnerships, but lacks a clear strategy in this area.** Realizing this potential would require detailed planning on how the innovative initiatives mentioned in the PRSP could be scaled up for significant impact. **Cross cutting issues such as capacity development and governance also do not get sufficient attention.** Specifically, there is an urgent need to build capacity among district education officials, and to implement strategies for improving teacher presence in schools. The CWIQ survey is a welcome instrument in this context, to establish a baseline on teacher absenteeism.

40. **The broad strategic direction and goals of the PRSP in health and population appears sensible and appropriate.** The PRSP recognizes the need to increase financing and enhance efficiency of spending through organizational and management reforms. Resources to the health sector are to be more than doubled over the next three years. Furthermore, the focus on reorganization of district health structures, strengthening of district and tehsil hospitals, improving hospital administration through greater autonomy, and regulation of private sector is well placed. On the programmatic front, the strategy rightly prioritizes control of communicable diseases (especially TB, malaria, HIV/AIDS, Hepatitis B, and the cluster of immunizable childhood diseases), reproductive health, child health, and nutrition. It goes beyond the National Health Policy in the important areas of reproductive health and nutrition through development of community midwifery, improvement of emergency obstetric care, behavior change and communication, and various nutrition-related initiatives.

41. **Nevertheless, the staffs note a number of important challenges that remain and are critical to improve outcomes in the health sector.** As in education, coordination across different tiers of government is essential to ensure that provincial and district governments are aligned to the same goals and priorities of the national government. More thought is also required on measures for strengthening management at the district level and below, more specifically, to elaborate concrete plans for improving effectiveness of first level care facilities that are widely known to be grossly underutilized. The strategy is also silent on human resource development issues. The health sector in Pakistan suffers from an imbalance of human resources with over emphasis on production of doctors and shortage of nurses. This is important since provincial governments continue to allocate more resources for medical colleges. Looking ahead, an important challenge will be to improve regulation and quality of the private sector—important since four-fifth of patients are using private health care. A

greater emphasis on evaluation and learning from various initiatives, such as public private partnerships and the hospital autonomy effort, would be welcome.

42. **The PRSP acknowledges the problems in delivery of basic municipal services in urban areas, and discusses plans for specific initiatives, such as the program to regularize and develop unauthorized/unserved settlements (Katchi Abadis).** That said, it lacks an integrated strategy necessary to address the full scale of problems in poor urban areas. Provision of housing and basic municipal services (water, sanitation, solid waste, etc.) to a large and growing segment of the urban population currently living in Katchi Abadis will become increasingly important since Pakistan's urban population is projected to increase significantly over the next decade. It is also not clear how the government proposes to handle the growing operating deficits, falling service standards, and large investment needs of the water/sewerage utilities in the large urban centers which can have major public health implications over the medium term.

43. **Targeting the poor and the vulnerable through safety net programs is one of the integral pillars of the strategy.** This pillar encompasses the expansion of microfinance, strengthening public works programs like Khushal Pakistan, improving transfer programs like Zakat and food support, and reforming pension systems for the formal private sector. The PRSP has recognized that several design and administration issues need to be addressed in order to improve the targeting and delivery of cash benefit and other poverty alleviation programs. However, many challenges remain, particularly with respect to increasing the coverage and reducing the leakage of benefits, which requires a systematic evaluation of the existing programs.

D. Risks to the Strategy

44. **Risks to implementing the authorities' program have been reduced since the I-PRSP.** As discussed in the JSA of the preparation status report, the staffs consider that the risks of political opposition and lack of continuity have diminished somewhat with the restoration of democratic institutions. The new government has continued to implement the reform agenda set out by the preceding government and completed the preparation of the full PRSP. While political opposition remains, the current government has also shown that it can pursue its policies without major disruptions, although, occasionally, it has found it necessary to delay measures, especially energy price increases. Still, active involvement of parliament would be key to ensure broad based political support for the PRSP reform agenda. **Delays in implementation, insufficient institutional capacity, and adverse exogenous shocks remain the biggest risks to swift reforms.**

45. **The staffs believe that achieving the PRSP's growth targets depends crucially on the implementation of the reform program.** Steadfast implementation of the reform program is essential for the creation of an enabling environment for the private sector, as well as to improve public service delivery. Weaknesses in tax administration and the energy sector, often mentioned as fundamental constraints to private sector development, need to be addressed promptly. Maintaining low and stable inflation will also be key to achieving the

growth objectives, and monetary policy will need to be geared accordingly. In addition, private (especially foreign) investment will only accelerate if the perception of political and military stability is further improved.

46. **Technical and institutional capacity has been augmented through substantial capacity building programs, but weaknesses remain.** The State Bank of Pakistan and the public banks have undergone major staff development programs. The Central Board of Revenue has embarked on a thorough-going reform, including staff renovation. Agency improvement plans have been developed for a large group of key agencies in the federal government. The Establishment Division has adopted a systematic improvement program in recruitment, training, promotion, and separation of federal civil servants. Provinces are following, although more slowly. Nevertheless, weaknesses remain in all areas, particularly in the newly formed district and local governments, although a number of donor-assisted initiatives are underway to strengthen capacity, particularly at the district level.

47. **Adverse exogenous shocks could set back the government's reform agenda.** As a result, growth could fall short of the ambitious targets set out in the full PRSP. In particular, political or security concerns could slow the projected increase in private investment, and unfavorable weather conditions could hold back agricultural production. Indeed a considerable improvement in international perceptions of security in Pakistan is needed to attract major inflows of direct private investment. In case of a major deterioration of security and political conditions, a reversal of capital inflows could put pressure on the balance of payments. On the positive side, sensitivity analysis shows that Pakistan could weather temporary shocks to the baseline scenario without public debt or external debt becoming unmanageable. Hence, the authorities should have some leeway to protect PRSP spending to some degree in case of adverse developments. Given these tangible risks, the staffs would have welcomed a more detailed discussion of the low case growth scenario and its implication for vulnerable groups and poverty trends.

V. CONCLUSION

48. **In the staffs' assessment, the PRSP represents an adequate framework for the country's efforts towards achieving sustainable growth and poverty reduction.** It has been prepared in a participatory manner and through consultation with all tiers of government, civil society, and the broader international community. The strategy is coherent and comprehensive, but to some extent lacks specificity. The assessment highlights the many challenges that remain and these form an agenda for further work. It is recommended that the next annual progress report include the following: (i) an explicit and prioritized roadmap of reforms and policy actions envisaged in the medium term with a clear timeline, especially in priority areas such as power and rural development, and including clear priorities for donor coordination; (ii) updating of the macroeconomic framework to include a low-case growth scenario, incorporating key risks and implications for poverty; (iii) addressing the critical issues related to governance, especially in the area of devolution; (iv) completing the costing exercise planned in the priority social sectors and progress towards developing the MTEF; and (v) implementing the CWIQ survey and finalizing broader institutional arrangements for

monitoring and providing timely feedback into the policy process, including poverty and social impact analysis of planned policy reforms, for example in the area of energy pricing.

49. The staffs of the World Bank and IMF consider that Pakistan's PRSP provides a credible poverty reduction strategy and provides a sound basis for IDA and IMF concessional assistance. The staffs recommend that the Executive Directors of the World Bank and IMF reach the same conclusion.