

EXECUTIVE SUMMARY

1. The North West Frontier Province is home to citizens famed for their sense of honor, bravery and hard work. This is borne out by their achievements in Pakistani metropolises and abroad. Yet, contrary to the true potential of its citizens, the NWFP is one of the poorest provinces in Pakistan.

2. The key to unleashing the NWFP's possibilities and to improving the lives of its citizens is strengthening the governance and policy environment in the province for both the private and the public sectors, and investing in the provinces' most valuable resource — its people. Reforms and efforts in the past few years have already started to translate into higher growth, improved incomes, and better living conditions for the citizens of the NWFP. This report outlines a strategy that builds on these successes and recommends policies to accelerate development in the province.

The Challenge

3. Geography, the fallout from international tensions, insufficient investment in human capital, and a policy environment unsupportive of the private sector have made the NWFP one of Pakistan's poorest provinces. Poverty in the NWFP is widespread, in particular in rural areas. Estimated per capita provincial GDP in 2002/03 was only 60 percent of the average for the country. As a result of lack of jobs in the province, workers find it necessary to migrate in search of better opportunities to the urban metropolises of the richer provinces (especially Karachi) and to other countries (especially in the Gulf). Remittances from migrants benefit nearly 40 percent of all households in the NWFP, helping many escape poverty.

4. The province's achievements in education and health are also below the national average. The literacy rate (10 years and older) in the NWFP was only 38 percent in 2001/02 compared to 45 percent for Pakistan and 61 percent in India. The infant mortality rate in the NWFP is high by international standards, but is the lowest in Pakistan at 56 per 1000 births. Estimates of maternal mortality are unavailable but improvements are likely to be modest given the persistence of high fertility, limited changes in the practice of deliveries at home, and the small proportion of births that are attended by skilled personnel. Only 58 percent of households in the NWFP have access to safe water, compared to 86 percent in Pakistan. And there is relentless population pressure driven by the high fertility rate of 4.3, compared to the Pakistan national average of 4.1, 3.2 in India and 3.1 in Bangladesh. The contraceptive prevalence rate is 30 percent, compared with 32 percent for Pakistan and far below the rates for India and Bangladesh.

5. The figures on health and education are provincial averages that mask vast disparities between men and women. Literacy and school enrolment rates for females in the NWFP are among the lowest in the country, whereas the corresponding ones for males are closer to (or sometimes higher) than the national average. Large gender gaps exist also in health outcomes and suggest low access to (and perhaps low demand for) preventive and curative medical care. Women's participation in economic activity (17 percent) is very limited, contributing to the province's low per capita incomes.

6. Poor education and health translate into low living standards, and have important economic consequences. Poor health of the household head is associated with lack of employment and the likely pauperization of the household. And children of households whose head is uneducated will often be illiterate themselves, trapping households in poverty across generations. These poor social indicators and the large gender gap hold back the provincial government's efforts to raise incomes and reduce poverty.

7. These unsatisfactory outcomes have to be seen against the backdrop of a pervasive view in the province that only the government can solve citizens' problems, both with regard to service delivery as well as employment and income generation. The private sector in the NWFP thus is weak and does not play the role that it does in the Punjab and in Sindh.

The NWFP: Features and Constraints

8. A development strategy for the NWFP should, of course, be shaped by the province's main features and constraints. While some of these constraints cannot be eliminated, many can be addressed by the Government of the NWFP and others by the national government. This report alludes to actions required from the national government, but emphasizes policies that are the provincial government's responsibility. Four characteristics of the NWFP merit special mention:

- ***Distance from seaports.*** The deep inland location of the NWFP translates into high transport costs, which increase prices for inputs and undermines the competitiveness of the NWFP's exports to countries other than neighboring Afghanistan. This suggests that the province's growth strategy should focus on production of products with a high share of raw materials that are indigenous to the province, that are light-weight and high-value, or that can be exported to countries that are physically close to the NWFP.
- ***A front-line state.*** The NWFP served as a front-line state and hosted more than three million refugees during the eleven-year war in Afghanistan and also for the period of the civil war that followed. Instability and security problems ensued, which discouraged private investment; and the inflow of refugees placed stress on the province's economic and social infrastructure.
- ***Limited private sector presence.*** While elsewhere in Pakistan there is a vibrant private sector that is responding quickly to the country's emerging economic opportunities, private enterprise in the NWFP remains anemic and well below its potential. A survey of perceptions of businessmen places Peshawar at the bottom of the list of major cities of Pakistan. The main reasons for this poor showing were perceptions (both of businesses based in NWFP and elsewhere) of greater policy uncertainty in the NWFP, weaknesses in tax administration and electricity shortages. This translates into limited job opportunities for the citizens of the NWFP, who find it necessary to migrate in search of employment.
- ***Uneducated workforce.*** The NWFP's rapidly-growing workforce is largely illiterate and unskilled. This translates into lower productivity of labor and discourages businesses from locating in the NWFP and creating jobs in the province. The flip side is that poorly skilled NWFP migrant workers are unable to secure more skilled, better paying jobs in Pakistani metropolises and the Gulf.

A DEVELOPMENT STRATEGY FOR THE NWFP

9. The first step towards providing a better life for the citizens of the NWFP is to increase their incomes. Increases in income are largely brought about by a rapidly growing provincial economy. In a modern economy, it is a vibrant private sector that provides productive employment to the labor force. If current trends in the labor force growth and the elasticity of employment with respect to real GDP are maintained, then the NWFP's real GDP will have to grow at a rate of about 6 percent annually for an extended period just to absorb the new entrants into the labor force. Reducing unemployment and emigration from the province below current levels will require economic growth of 7–7.5 percent per annum.

10. The poor in the NWFP are clustered around the poverty line, thus even small increases in their household incomes can translate into large changes in poverty incidence. This means that a strategy that succeeds in generating a reasonable rate of growth in real per capita incomes can lift large numbers of households above the poverty line.

11. A strategy for growth and poverty reduction will require action on four fronts. The authorities will have to:

- ***Sustain rapid economic growth***, driven by a vibrant private sector. A higher rate of provincial GDP growth is the most effective way to increase incomes and reduce poverty.
- ***Accelerate improvements in the indicators of education and health***, so as to allow the poor to contribute to and benefit from economic growth. In addition to directly improving welfare, better educated and healthier workers are more productive. A key element of the strategy should be a specific plan to improve the education and health status of girls and women, and to reduce the province's high fertility rate.
- ***Strengthen social safety nets*** so that those families that, for reasons of health or other negative shocks, are unable to participate in economic activities are protected from extreme poverty. Provincial policies with regard to social safety nets should complement or strengthen existing federally-sponsored safety net programs.
- ***Develop and implement a specific development plan for the more backward areas*** of the NWFP, such as the mountainous regions.

12. Elements of the development strategy are beginning to be put in place in the economic and social reforms of the past few years, and this is now beginning to bear fruit. Recent trends, revealed by the recent FBS' 2004/05 Pakistan Social and Living Standards Measurement Survey, indicate that key social indicators are beginning to improve, and that some progress has been made in bridging the gender gap. This early success now needs to be ratcheted up by deepening and broadening the development strategy and strengthening implementation.

13. This report argues that achieving the NWFP's development objectives — particularly the central one of poverty reduction and job creation via rapid economic growth — will require that the provincial government **focus scarce administrative and financial resources on its core functions**, i.e., the provision of basic public goods (roads, irrigation infrastructure, water and sanitation, education and health, and research), the design and implementation of modern regulation to promote competition, the facilitation of the entry of new firms into the NWFP as well as the exit of those that cannot compete, and the protection of property rights (through land registration, policing contracts, and an efficient legal system). Focusing on the core functions means that the provincial government must step back from many activities it is currently engaged in, so as to **create space for the private sector**. This will allow the private sector to mature into the main source of employment and an active partner in the delivery of many services (education and health, infrastructure, etc).

The Drivers of Growth

14. The development of a vigorous private sector that plays the same dynamic role in the NWFP as it does in Sindh and the Punjab starts with a credible dialogue between the government and the private sector to clarify their respective roles in the economy, with the government focusing on its core functions (as outlined above) and the private sector engaged in the direct production of goods and services. A private-sector-driven growth strategy requires the creation of trust between the parties that the new

strategy is here to stay, and that it will not fizzle out as in the past. To convey this signal, the NWFP government must disengage from activities such as the financial services, transport, and construction. To that end, the government must consider:

- privatizing the Bank of Khyber, the largest bank in the province;
- allowing industrial estates, currently under SDA, to be privately managed; and
- permitting the private sector to provide maintenance for infrastructure.

These actions will provide concrete evidence that a new relationship is emerging. In addition to maintaining an over-arching dialogue with the private sector, the authorities should also help to address the critical issues in specific activities in which the NWFP is likely to be competitive. Some of these areas are discussed below.

15. Manufacturing based on materials that are indigenous to the province is a sector that offers the potential for considerable growth that needs to be fully tapped. Especially important in this context are marble, granite, and construction materials, the latter particularly for Afghanistan's reconstruction. The NWFP possesses considerable resources of marble, which could form the basis of a flourishing industry. However, an analysis of the value chain for marble carried out for this report revealed that the development of this industry is currently constrained by a number of factors. These include (i) ambiguous ownership rights, which limit access to finance; (ii) inefficient technological practices, such as the use of blasting as the most common extraction method that destroys much of the material and produces low value blocks; and (iii) scarcity of skills to finish and polish the stone. Moreover, the poor state of the province's roads means that the cost of transporting marble from the mines to places where the stone is polished and/or exported is higher than those in competing nations. As a result, much of the value of this resource is lost to the NWFP. Reaping the potential offered by this subsector will require significant intervention by the government.

16. The construction industry merits particular attention by the government, because of its vertical and horizontal links with other industries, and because it is an activity that generates considerable employment. An important part of the demand for the provincial construction industry is provincial government contracts for public works projects. However, there are frequent problems of collusion, cost overruns, low quality, and corruption, which hamper the development of a competitive private sector. Introducing a standard set of contracts used by all agencies that hire construction firms for civil works, and simplified, unified registration would help eliminate some of these problems. The provincial government should also implement a system to monitor performance of private contractors with new contracts awarded only to contractors with a record of high performance.

17. Energy. The NWFP also does not take full advantage of its hydel potential. Two broad possibilities are raised. First, the province can earn revenue by selling electricity on the national grid. Second, the province can set up electricity stations that, while covering their costs, could sell power within the NWFP at a lower rate — subject to that these suggestions are implemented in line with the National Energy policy, and to NEPRA's tariff determination and wheeling and distribution charges — than the power provided on the national grid. The lower price for electricity could help to offset some of the transport disadvantages arising from the province's geographical location that affect competitiveness.

18. Tourism. In the long run, tourism offers a source of employment and income generation. Given the unsettled regional situation, the immediate prospects for international tourism are limited. However, it is worth exploring the prospects for attracting domestic tourists to the Northern Areas, which so far have not been affected by the law and order situation. The province must develop a comprehensive policy

for tourism and strengthen the institutional structure for tourism. The provincial government needs to develop, in consultation with the private sector, a strategy to guide investments in promotion, skill development, infrastructure, and environmental protection.

19. An important element in the development strategy should be the *use of urban centers to stimulate the growth process*. The potential for growth in urban centers arises from the concentration of skills in a relatively small area, which facilitates specialization and the division of labor. Additionally, conglomerations of large populations create markets, which can be economically served by the specialized skills. The other side of the coin is that large population agglomerations can be politically quite vocal and thus would require, *inter alia*, a more rapid and satisfactory delivery of at least the basic services. The use of urban centers as growth engines in the NWFP must begin with Peshawar's economic potential and by solving its management problems. Much of what constrains Peshawar from developing arises from the multiplicity of agencies responsible for different functions in the city. The authorities must therefore improve the coordination of planning and implementation of development schemes between these agencies by establishing an apex agency, and strengthen the technical capacity of the different agencies to plan and manage development projects by hiring suitably qualified personnel from the market.

20. **Land markets.** The poor functioning of land markets in the NWFP ties up a large amount of resources in litigation between citizens and also between private persons and the government. Moreover, so long as a clear title of ownership is not established, it is very difficult to offer the property as collateral for borrowing that could be used in investment. The most formidable constraint to the efficient functioning of urban land markets is the failure of land management systems to establish ownership of urban properties. The most important requirement to make land markets function optimally is to put in place a system that determines title conclusively. Other measures to improve the functioning of land markets would include:

- disposing of provincial and local government land in prime commercial locations that is used for less productive purposes, or presently leased out for a nominal rent;
- consolidating the responsibility for determining title in one department;
- making it compulsory to register transactions related to properties;
- raising the land non-utilization fee on plots that remain vacant in housing schemes after the associated infrastructure has been provided;
- enacting legislation to abolish the *benami* holding of property; and
- narrowing the differential in property tax paid by rented and owner-occupied properties.

21. **Growth in agriculture** will play a central part in the NWFP's growth and poverty reduction strategy, in light of its economic potential and because the majority of the poor live off agriculture. The strategy recommended for agriculture is to move away from an emphasis on food self-sufficiency in cereals towards food security and rural income growth. This will require employing the province's scarcest resource, irrigated land, in activities that provide the highest returns, and using the funds generated thereby for the purchase of cereals and other commodities in which the NWFP has no obvious comparative advantage. The proposed strategy does not of course mean that the province should abandon the production of cereals altogether. Rather, it means that the best way to generate growth and employment in agriculture is to encourage the movement of farmers towards high value activities, such as livestock (the production of which is already increasingly rapidly in the province) and horticulture. In order to assist the move towards high value activities, the government will have to:

- establish key public infrastructure, such as transport links and cold storage facilities, to reduce post-harvest losses of high-value products;
- create a research system that undertakes best-practice research of relevance to all farmers in the province; this research system could focus on introducing varieties of sheep for high-quality wool production in the high mountain areas and breeds of goats suitable for rearing in the southern districts; improving fodder and grazing techniques to improve for livestock productivity; developing varieties of high-value horticulture of particular interest to the southern districts (e.g., olives, berries, dates);
- strengthen the linkages between agricultural research, extension and farmers to ensure that research and extension priorities correspond with farmers' needs and market trends;
- develop partnership with farmer organizations and the private sector to improve input and output market information through the use of media and extension services; and
- build the capacity of small farmers through the development of farmer organizations, including by revising the remit and expanding the coverage of Farmers' Service Centers. Farmer organizations are essential to capture scale economies, and to ensure the provision of services with common property or public good characteristics (e.g., irrigation; market intelligence for sub-groups of producers) as well as to provide the interface between extension service providers and farmers.

22. The NWFP is home to some of the most important natural resources in Pakistan, particularly forests. Hence, the government should pay special attention to conserving these resources, by constructing a policy environment that supports active forest management for sustainable harvesting of timber. This would require:

- providing incentives to communities for the sustainable management of their natural resources by establishing ownership and/or user rights that encourage joint management;
- strengthening institutional capacities for rangeland management, particularly in the southern rangeland; and
- supporting provincial research in natural resource management, particularly relating to forest conservation and range management.

Delivery of Public Services

23. Accelerating economic growth and poverty reduction in the NWFP will require major investment in human capital. Education and health are often the only assets of the poor, so improving them is required not only for improving the quality of life of the poor directly, but also for providing businesses with an educated, productive, and consequently well remunerated workforce. The education and health status of the population in the NWFP, while improving, still lags that of more developed areas of Pakistan and is well below that of neighboring countries, such as India, Bangladesh, and Sri Lanka. The most salient feature of health and education outcomes in the NWFP is that they are particularly weak for women.

24. The challenges for sustained, rapid human development are formidable, but achievable if the root causes of the poor public service delivery are identified and addressed effectively. At the root of the NWFP's poor social outcomes lie deficiencies in the delivery of health, education and WSS services by the public sector, some of which are systemic, some sector specific. Systemic problems affect service delivery in health, education, and water and sanitation in similar ways and include (i) ***inadequate implementation of devolution*** (administrative, functional and fiscal) to local governments; (ii) ***weak management information systems***, and poor alignment of policies and resources with results on the ground; and (iii) ***poor transport*** accessibility in rural areas. In order to effectively address the systemic problems that attend on poor service delivery, the authorities will have to:

25. (i) ***Devolve administrative and fiscal powers to local governments.*** The devolution initiative of 2001 opened possibilities for improved accountability and strengthened managerial authority of local governments and community involvement in service delivery. However, the steps necessary for making devolution effective have yet to be implemented in the NWFP, and consequently administrative, functional, and fiscal devolution are far from complete. This produces weak accountability, both of policymakers to citizens for poor service delivery and of service-providing staff to policymaker. As a result of limited local control over staff and unclear roles and responsibilities between different levels of government, local elected policy makers do not have sufficient managerial authority over their staff to hold them accountable for failure to improve services. It is therefore hardly surprising that government teachers, nurses, and doctors are frequently absent from duty and that basic health units and clinics are often without medicines and other necessary supplies.

26. Acute staff shortages and lack of adequate skills in district governments and TMAs also constrain service delivery. The skills deficiency is worst in the TMAs, where inadequate devolution of requisite staff has led to weaker technical capacity. Reflecting a mismatch between grade levels, responsibilities and required skills, key planning and service delivery positions are often manned by very junior and under-skilled staff, which lacks the capacity to perform these functions. The main issues to be addressed include:

- **Increasing local authority over recruitment and career management.** Devolution in the NWFP has ironically led to a high degree of administrative and financial centralization *within* the district government. This centralization in the context of dual authority has undermined efficiency of the district administration and has hampered budget execution, in particular that of the development budget, in a number of districts. In addition, while in theory local governments can create and eliminate sanctioned posts, the provincial government retains *de facto* control over establishment decisions. As a short-run solution, the provincial government could give the Public Service Commission oversight over recruitment of district staff to ensure merit and transparency, particularly for key service delivery staff. It could also involve the Public Service Commission in vetting requests of transferring senior staff in less than the three years as set out in the Rules (as was the practice in the past). The provincial government should also start working on developing a local district service, which would ensure that all staff in the districts is managed only from within the district.
- **Completing functional devolution.** Overlap in functional responsibilities is considerable. In the water supply and sanitation sector, for instance, lack of effective managerial authority has resulted in a lack of functional devolution. This has led to an overlap of mandates between different levels of government, with confusion in the roles and responsibilities for service provision. The TMAs have the legal mandate but lack the requisite staff, and the districts do not have the legal mandate but have the staff and in fact provide these services. This institutional misalignment has compromised the planning and implementation of WSS, with major adverse implications for the sustainability of the WSS systems. The provincial government should

devolve the responsibility for the delivery of water and sanitation services to the TMAs (as per the LGO), accompanied by the requisite transfer of PHED staff.

- **Strengthening community involvement to reduce staff absenteeism.** Weaknesses in the institutional mechanisms for community involvement in service delivery (such as monitoring committees of local councils, PTAs, etc.) limit the degree of citizens' control in the management and oversight of service providers. Also, since the provincial government continues to wield its authority over education and health personnel located in the districts, monitoring committees and PTAs are unable to elicit a response from the district bureaucracy on their recommendations for disciplinary actions against excessively absent staff, and are therefore rendered ineffective. Addressing some of these problems would involve monitoring committees formally in the budget process in a consultative role; provide them with adequate resources for facility inspections; and make civil servants' reporting responsibilities to them clear.
- **Furthering fiscal devolution.** Local governments do not have sufficient resources to adequately implement their mandate. The provincial government should increase transfers to local governments through the PFC mechanism. A new NFC award that would transfer a higher share of the divisible pool to provincial governments could help alleviate some of the financial pressures on the provincial government.

27. **(ii) Improve access to transport in rural areas.** Road accessibility is a prerequisite for receiving education and health services. Improving the provincial road transport system and infrastructure can also contribute to faster economic growth by lowering production costs. Transport costs act as one of the major competitive barriers for firms in the province, and are high because of the poor quality of service.

28. Poor road accessibility, especially in remote areas, reflects a number of underlying problems. The province lacks a transport sector policy for identifying priorities and setting out the government's strategy to address them. Funding for road maintenance and repairs is inadequate and unpredictable. Priority is given to new developments, as opposed to maintenance of the existing infrastructure. This results in long delays in completing projects (the current project completion time is 14 years) and causes huge economic losses for the province. The priorities to be addressed in the transport sector thus include:

- **Developing a provincial transport policy and strategy.** The policy should take into account the new roles of the various levels of government after devolution. It should place a high priority on improving the rural population's physical access and mobility.
- **Rationalizing the road investment program and giving priority to road maintenance.** Expenditures on roads could yield better value for money by improved planning and prioritizing of road maintenance and rationalization of the road investment program. Measures for road maintenance could be made more robust by shifting some of the burden of financing the costs of infrastructure maintenance and preservation to road users.
- **Putting in place incentives to promote better and more participatory planning and accountability.** Road users should have a say in ensuring that their contribution is used efficiently by having representatives in FHA board, and by involving communities in designing and implementing rural access and mobility improvement schemes.
- **Putting in place a monitoring and evaluation system** to assess the impact of sector policies and provide a feedback to planners, decision-makers, and stakeholders.

29. ***(iii) Improve the reliability, timeliness, and credibility of government monitoring systems; make better use of these data sources, as well as of independent data to monitor performance.*** Systems of service delivery can only be improved if their performance can be monitored quickly and the reasons for any unsatisfactory execution rapidly analyzed. The Health Management Information System (HMIS) and the Education Management Information System (EMIS) need to become real time information tools for provincial managers to get timely and accurate information for management decisions. In addition, the provincial government could make better use of existing national-level data collected by the Federal Bureau of Statistics, such as the Pakistan Integrated Household Survey (PIHS) and the Labor Force Survey. Also, the 2004/05 PSLM-CWIQ can provide very recent provincial and district level data on key health and education outcomes and underlying factors, as well as on satisfaction levels with other government-provided services. These data sources could be used to inform the direction of future policies and decisions (e.g., the Provincial Finance Commission Awards) and identify the districts where more focused attention by the government is needed.

Education Services

30. The Government should set feasible but ambitious education and health goals for itself as an integral part of a provincial development strategy. It should aim for universal primary education and a doubling of secondary school enrolment over the next decade; doubling the average years of schooling of the labor force to narrow the gap with competitor provinces and countries. It should also aim to improve the quality of college education and orient it to the needs of the private sector.

31. Meeting these goals requires focusing on three major challenges: (i) low overall school attendance compared with neighboring countries; (ii) a wide gender gap — i.e., particularly low school attendance for girls; and (iii) a wide rural–urban gap, with particularly low school attendance for girls in rural areas. There is also wide variation across districts in NWFP, with district net primary enrolment rates ranging from 80 to 16 percent and the gender gap in net enrolment varying from 2 to 23 percent. The low school attendance reflects problems in two broad areas: access to education and poor quality of public education.

32. Factors that constrain access to education in the NWFP are the cost of schooling, the distance to nearest schools and schooling availability, cultural factors such as parents’ concerns about security for their daughters and a preference for female teachers, and total education supply including both the private and public sector. The central causes of the poor quality of public education are widespread governance problems that result in low teacher attendance, school closures, often poorly-qualified teachers, and a serious shortage of schools in rural areas. Finally, allocated non-salary budget funds often do not reach the intended local school but are illicitly diverted.

33. As a result of these deficiencies, 1.9 million children (of which 1.1 million are girls) in the 5-9 years age bracket are left out of school with an overall Net Enrolment Ratio (NER) of 47 percent. The government should aim at increasing overall enrolment by at least 6 percent annually and female enrolment by 8 percent annually. This would mean that annual enrolment for 5-9 year olds would increase from 1.7 million students (0.7 million girls) in 2004/05 to 2.3 million students (1 million girls) in 2010 and to 3.0 million by 2015 (1.5 million girls). The overall NER would improve to 66 percent by 2015.² In order to achieve this, the government will have to enlarge access to education and improve its quality.

² The National Institute of Population Studies is in the process of revising its population projections for 2015. According to the projections available in the spring of 2005 while preparing this report the 5-9 year old cohort in 2015 would consist of 4.7 million children. The new revised projection is 2.7 million 5-9 year olds in 2015. The new cohort figures are significantly less than the previous projections and will mean a much smaller supply side constraint faced by the school age children in the coming years.

34. The government's strategy to expand **access** to education should reduce the cost of schooling for households; address parents' concerns for the safety and security of girls; scale up education supply by engaging the private sector; and focus efforts on districts (and areas within districts) that lag behind. To this effect, the report recommends that the government:

- Reduce households' cost of education by introducing stipends for students, whether they attend public or private institutions;
- Raise demand for girls' education by providing missing facilities to all secondary schools for females, consider subsidizing travel costs for female teachers in rural areas, and increasing stipends for female students;
- Engage the private sector by making the two Education Foundations autonomous organizations that act as apex bodies whose role should be to support private initiatives in providing education;
- Focus government's attention on the most underdeveloped districts. These could also include constraints outside the education sector with a bearing on education outcomes, such as lack of access to transport in remote areas.

35. The strategy to improve the **quality** of public education should, as a minimum, ensure the presence of qualified teachers; both formal and community supervision of teaching practices and stronger accountability; competition amongst schools; and ensure that allocated non-salary funds reach the schools. To this effect the report recommends that the government:

- Ensure better teacher attendance by the following measures: (i) making all new teacher appointments school specific; (ii) enabling more frequent supervision at the schools by education officials through increased funding for monitoring of schools and reducing the number of schools assigned to each ADEO; and (iii) empowering PTAs to recommend and monitor disciplinary actions beyond transfers of negligent teachers.
- Strengthen teacher management by supporting the separation of teaching and management cadres and provide professional development plans and training support for both cadres. Ensure school-specific budgets for primary schools and transparency of budget information to the public to check leakages of school funds.
- Encourage competition among schools by providing school vouchers to low-income families aimed at picking up the tuition and other expenses of education at public and private schools.
- Contract out the management of chosen public schools to a reputable NGO.

36. Strengthening secondary and higher education at the province level (colleges up to grade 14) is also important for economic growth and poverty reduction. Monitoring of outcomes and provision of management information is particularly weak for higher education. The government should speed up development of an EMIS for higher education. The college sub-sector should have a direct link to private employers in order to identify the set of qualifications that are in high demand in the provincial economy, and redirect the teaching resources accordingly. Skilled workers are in higher demand and are more likely to migrate. Hence the province needs to significantly increase the education level both of potential migrant workers and of the work force that will remain and drive its economy. Upgrading the skills of the work force must start with improved primary and secondary schooling.

Health Services

37. The state of public health in the NWFP is poor. The share of children between 12 and 23 months that have received full immunization (the immunization rate) is only 60.5 percent. Thus, currently 650,000 children of this age are left without immunization each year. The Contraceptive Prevalence Rate (CPR) at 30 percent lags behind the national average of 32 percent and is far below comparable rates for India and Bangladesh. About 2.5 million married females aged 14-44 years are not covered.

38. The government should aim at raising the immunization rate for children 12-23 months to 80 percent by 2015. This means that the number of children to be immunized each year would rise from 0.99 million in 2004 to 1.3 million in 2010 and 1.6 million in 2015. The provincial government should aim at raising the contraceptive prevalence rate to 40 percent by 2010 and 48 percent by 2015. In view of the rapid growth of population, even with these efforts the number of married females not covered will decline only to 2.4 million by 2010 and 2.3 million by 2015.

39. Why is the public system for primary care services so inadequate? The answer is to be found in weak management, inadequate staff motivation, and little emphasis on measuring results. Management at the district level lacks strategic orientation and management skills are limited. Staff is unaccountable, barely supervised, with little or no incentives for performance; consequently, absenteeism among doctors and other health personnel is high and widespread. In addition, the poor health outcomes reflect low public expenditures on health services (amongst the lowest in the world) and low quality of the services provided. The latter leads to low demand for peripheral services for primary care. The fact that these services are underutilized is a core issue in health care delivery in NWFP. Measurement of results is episodic, and there is no incentive to use the data that exist. Little systematic monitoring and evaluation (M&E) is performed by the provincial government.

40. A strategy for improving delivery of health services must encompass several elements. The *first* element is a **willingness to undertake bold reforms and testing innovations**. Progress in provincial health outcomes requires significant improvement in the delivery of publicly-financed preventive, promotive, and curative services. A few high priority actions should be selected, based on good evidence or rigorous pilot-testing. The pilots should be independently evaluated so that lessons could be learned and applied to future efforts.

41. The *second* element in the government's strategy should be to **test contracting-in management of primary health care facilities**. The government should consider splitting the financing and provision of health services, which could be done by contracting out the management of health services. It should quickly begin a large-scale pilot in a few districts by contracting with an NGO to manage primary health care infrastructure (RHCs, BHUs, and LHWs). This approach builds on the experience in Rahim Yar Khan District in the Punjab where the district government contracted an NGO to run all 104 BHUs.

42. *Third*, the government should **make the system more results-oriented and collect data to measure results**. The government should establish an independent Monitoring and Evaluation Unit. This unit should have the analytical skills to assess the performance of the health system by analyzing data from household surveys, facility assessments, and management information systems. Better M&E is likely to improve performance by increasing accountability.

43. *Fourth*, the government should play its role in **ensuring that the quality of care in the private sector improves**. As measures to ensure that the quality of care in the private sector improves, the government should begin pilot testing participatory approaches. These pilots could include: (i) working with NGOs and professional organizations to improve tuberculosis and ARI case management among private providers; (ii) fostering a hospital accreditation system among private hospitals; and (iii) initiating

a participatory approach to pharmacy regulation, including NGOs, academics, government, and pharmacists.

44. *Fifth, test real autonomy for DHQ/THQ hospitals.* In the short term, conduct an independent and detailed evaluation of the experience of the NWFP's hospitals with autonomy. On the basis of this review, the GoNWFP should design a pilot to test "real" autonomy in some 10 DHQ and THQ hospitals to be implemented in the medium term. Independent hospital assessments, including the use of control hospitals, should be carried out to determine objective measures of performance. Based on an independent evaluation of results, the government should make a decision on whether and how to expand the approach.

Water Supply and Sanitation

45. Only two-thirds of the NWFP's population has access to clean drinking water, 69 percent access to toilets, and 38 percent access to sewerage. These deficiencies contribute to the high infant and child mortality rates in the province. The government should aim at raising the coverage rate for clean drinking water from 66 percent to at least 76 percent in 2010 and 83 percent in 2015. This requires extending the supply to 18 million persons in 2010, up from the present 13 million, and further to 21 million in 2015. The government should also aim at increasing access to toilets to 78 percent of the population in 2010 and to 85 percent in 2015. This would increase access from 14 million persons at present to 18 million in 2010 and to 22 million in 2015. Access to sewerage should increase from 7 ½ million persons to 10 million in 2010 and further to 12 ½ million in 2015.

46. These challenges can only be met if the government overcomes two sector-specific problems that limit WSS coverage. First, questions of accountability between levels of government must be resolved; otherwise there is a significant risk that the WSS systems will fall into disrepair, compromising even the service level that existed prior to devolution. TMAs are reluctant to accept responsibility for WSS systems previously managed by the districts' Public Health Engineering Departments for two main reasons: (i) funds for Operation and Maintenance (O&M) of these systems are not being transferred to the TMAs; (ii) there are huge outstanding liabilities against the WSS systems (particularly electricity arrears to WAPDA) that were accumulated prior to the establishment of district governments by predecessor agencies. The question of which level of government should shoulder these liabilities is still unresolved. The TMAs cannot bear this financial burden; their capacity to adequately finance O&M of own WSS systems through user charges and own source revenues is also limited. Second, since TMAs are heavily dependent on transfers of Urban Immoveable Property Tax (UIPT) revenue from higher levels of government, persistently delayed UIPT transfers hurt WSS operations in all TMAs. Relatively backward TMAs are particularly hard hit since they are heavily dependent on the UIPT transfers to maintain their day-to-day affairs.

47. Both the federal and provincial governments have a responsibility to ensure that TMAs have the administrative and fiscal space to deliver water and sanitation services. The report recommends that the provincial government:

- Provide TMAs with an incentive to take over the operation and maintenance (O&M) of WSS systems constructed by PHED. The O&M funds that the PHED receives from the provincial government could be such an incentive, which could be phased out in a time period agreed at the time of the transfer of the systems to the TMAs.
- Assume all pre-devolution liabilities relating to the existing functional rural water supply/sanitation systems and ensure that all funds allocated for O&M of these systems be transferred to the respective TMAs. The systems should be transferred to TMAs under

- agreements laying down all understandings, rights, obligations, roles, and responsibilities of all the concerned parties for subsequent O&M.
- Collect UIPT in a transparent, documented manner, in coordination with the respective TMAs. The amount due to the TMAs should be transferred in accordance with an agreed, predictable schedule.
- Assist TMAs in identifying and generating own funds.

A Fiscal Framework for the NWFP's Development Strategy

48. As discussed above, setting the NWFP on a rapid development path requires sustaining a rapid rate of economic growth (7–7.5 percent per annum) and stepping up investment in human capital. It is estimated that growth at these levels would create an additional 1.2 million jobs by 2010, which added to the 4.7 million employed in 2005 would cause unemployment to fall to 9.6 percent of the labor force (from 13 percent in 2005). A strategy that will most effectively attain these ends will require that the provincial government abandon some of the activities it currently performs, focus its efforts on the core functions of government — providing public goods and services, formulating and enforcing regulations, and strengthening the basic institutions of a market economy such as the police, the judicial system, etc.) — and perform those functions better.

49. The high-investment/high-growth strategy proposed in this report will have important development rewards, but it will require additional public resources. Stepping up the delivery of roads, irrigation, energy, and other infrastructure requires that both provincial and local governments increase the level of, and the returns to, public investment. In order to improve the delivery of social services, increased expenditures must be combined with sector-specific actions in education, health, and water and sanitation and complemented by measures of fiscal decentralization that would give service providers (local governments) the wherewithal with which to deliver the services. Thus, setting the NWFP on a more rapid growth and poverty reduction path will have important financial implications for provincial and local governments and, since much of the finance will have to be provided by the national exchequer, there will be significant implications at the national level as well.

50. Additional resources can be mobilized mainly from three sources: (i) own provincial and local government resources; (ii) transfers from the federal government; and (iii) borrowing. The NWFP will have to be active in tapping each of these possibilities.

- **Enhanced own resource mobilization.** Renewed revenue reforms to enhance the mobilization of own resources should help raise the provincial own revenue ratio from 0.7 percent of GDP in 2004 to at least 0.8 percent of GDP during 2005-2010. In order to attain this, the province will need to step up its efforts to improve tax administration, remove exemptions, expand the tax base by bringing in hitherto untaxed areas, harmonize tax rates by coordinating with other tax jurisdictions, abolish taxes with little yield, and avoid using regulatory taxes for revenue purposes. Other measures could include reviewing options for auction/lease of high-value state-owned lands for urban development; and privatizing public assets.
- **Larger federal transfers** through a new NFC award, with a higher share of the divisible pool going to the provinces. While the bulk of service delivery responsibilities and expenditure assignments rest with provincial and local governments, most of the revenue in Pakistan is collected at the national level. The current NFC formula provides insufficient resources to fund the expansion in public investment and the improvement in social services that is required by the

province. A higher award of the divisible pool to the provinces would reduce the stress on provincial finances.

- **Hydel payments from WAPDA/federal government.** Because of WAPDA's poor financial health, the transfer from the central government for Net Hydel Profits (NHP) has been capped at Rs 6 billion since 1991/92. In the context of the continuing price inflation, the real value of these payments has eroded by more than 60 percent between 1991/92 and 2004/05.
- **Prudent borrowing.** If the provincial government's reforms succeed in initiating a high-growth scenario, it is likely that the international financial institutions (IFIs) would offer to support these efforts. This financing should provide a significant amount of support to the budget. However, in order to ensure the sustainability of the GoNWFP's debt, the government should prioritize grants over borrowing, and borrow on the most concessional terms available.

51. Accelerating growth requires not only increasing the overall level of expenditures, but also improving the composition and efficiency of public expenditures. This means that the provincial government should emphasize investment and operations and maintenance rather than consumption, and direct attention to the better management of investment projects. For growth to accelerate to 7–7.5 percent, the projections indicate that development spending must rise from an average of 1.8 percent of GDP in FY02-04 to an average of at least 2.2 percent of GDP in FY05-10. Spending on Operations and Maintenance (O&M) of infrastructure should increase from 0.9 percent of GDP in 2004 to at least 1.1 percent of GDP by 2010. Public consumption (excluding O&M and non-salary transfers to districts) should be contained to a maximum of 4.9 percent of GDP on average over the next three years; thereafter it should decline and not exceed 4.7 percent of GDP by 2010.

52. The latter estimate reflects efforts to contain growth in the wage bill (in current prices) of the civil service. The projections include a general civil service pay increase of 18 percent in FY06 plus the regular annual wage creep of 3–7 percent, but assume that growth in the real wage bill will be contained to no more than 6 percent a year subsequently.

53. There is considerable scope for improving the efficiency of public expenditures. Public investment projects in the NWFP do not reap the full benefit from this use of scarce public funds. The management of public investment expenditures suffers from deficiencies at each stage, including project planning, selection, implementation, and monitoring and supervision. Since public expenditures form the bedrock of the government's efforts to stimulate growth and reduce poverty (including through their role in "crowding in" private investment), it is essential to examine the reasons why their impact has been inadequate and to try to rectify these deficiencies.

- *First*, the public investment program is not aligned with the goals and targets of growth, poverty reduction and human and social development set by the province. The government should start implementing a rolling medium-term budget framework (MTBF) that is closely focused on the foregoing goals. The effectiveness of this as a planning tool would be heightened and the disconnect between policy goals and the expenditure profile more effectively addressed, if regular consultation with major shareholders were made a part of the process.
- *Second*, the allocation of funds for O&M is inadequate and not in tune with the public investment program. The government should provide adequate overall O&M funding for each project over its lifetime, and revise upwards the present obsolete yardstick for allocating O&M funds.

- *Third*, the quality of the project portfolio is compromised by problems of selection and cost. These embrace the inclusion of projects not approved by the Provincial Assembly, poor initial cost estimates, and frequent cost escalation. A lack of consistent criteria for project selection has led to ADP funds being spread thinly and to a high throw-forward of development projects. Moreover, projects are frequently subject to amendments in the scope of work, thereby creating opportunities for leakages.

It is recommended that projects be considered for inclusion only after being cleared by a representative and adequately empowered Concept Clearance Committee (CCC). This Committee would be responsible for developing and implementing transparent criteria on the basis of which projects would be selected and prioritized. Low priority projects should be weeded out, following a review of the existing project portfolio. It is also recommended that the current practice of allowing a 10 percent buffer in the cost between project approval and grant of technical sanction should be reduced in order to encourage more accurate cost estimates from the very beginning of the project cycle.

- *Fourth*, time and cost overruns are widespread. Implementation is protracted, because of the slow preparation of project approval documents (PC-1s) and/or funding that is inadequate in relation to the project's funding schedule. It is therefore essential that planning and budgetary procedures ensure the timely preparation of PC-1s and that funds are provided in accordance with the phasing in the PC-1.
- *Fifth*, in spite of the 2003 Procurement Law, procedures and practices continue to obstruct competition in the selection of contractors and the procurement of goods and services. In order to ensure transparency and competitiveness, the government should align this law with international best practice and insure the enforcement of the law and Standard Bidding Documents in all public procurement.
- *Sixth*, projects are insufficiently monitored and supervised. This reflects inadequate funding, lack of qualified staff, and deficiencies in institutional capacity in the provincial and district governments for monitoring and evaluation (M&E). The government must recognize that M&E activities are essential to ensuring the effectiveness of public expenditures and that therefore they should be adequately funded and conducted by qualified personnel.

54. **Accelerating delivery of public education, health and water and sanitation services requires a higher level of transfers to local governments and more appropriate criteria for allocating these transfers among districts.** Four years after devolution, the fiscal system provides few opportunities or incentives for local officials (such as *nazims* and DCOs) to rationalize local expenditures, or to steer more resources to where they are needed. Several factors undermine the potential for more effective service delivery by local governments. While the province is highly dependent on resource transfers from the federal government, there is an even higher dependence of the districts on transfers from the provincial government. However, since these transfers are based on opaque criteria, the transfer system is perceived as creating inequities between districts. Own source revenues at the district and TMA levels are negligible, and thus cannot compensate for shortfalls in resource transfers from the provincial government. This raises issues of the design of the transfers and lack of incentives for local governments to mobilize own revenues.

55. The vast majority of funds transferred to local governments are governed by criteria that could be more transparent. Only transfers for development and non-salary expenditures (a small share of total transferred funds) are allocated on the basis of an explicit formula. All other transfers are based on existing establishment costs (e.g., wages and electricity allocations), estimates based on outdated revenue-

raising estimates (such as Zila and Octroi offsets), and estimates of recent revenue collection (e.g., UIPT shares). Current staffing allocations across districts show significant inter-district inequities in per capita wage expenditures. The provincial government can take several steps to address these problems. For example, it could: (i) pass on the wage bill of devolved departments through Account IV (as a first step); (ii) enhance transparency by developing a suitable formula for devolving the salary bill; (iii) coordinate reforms in fiscal transfers with movements in administrative devolution.

56. **Local governments need more autonomy in spending decision.** About 80 percent of the transfers to districts consist of funds earmarked for salary payments; the rest are formula-driven allocations for non-salary and district development expenditures. This leaves districts with limited spending autonomy, no incentives to strive for efficiency gains, and no leeway to change the salary and non-salary mix in expenditures. The provincial government may consider giving incentives to districts to retain savings in wages, non-salary and development expenditures, and allowing districts to retain savings if sanctioned posts are abolished.

57. **To increase resources available for local governments, the provincial government could provide district governments with a stronger revenue base and should ensure that the present system does not discourage own revenue mobilization.** For this purpose, the provincial government could allow districts to retain collection of user charges, e.g., in health, user fees for agricultural implements and veterinary services, etc. It could also devolve the agricultural income tax and improve the design of the matching grants system for additional revenue collection.

58. **The province will need to improve its monitoring and evaluation system for decentralized policy making, starting with key fiscal and socio-economic indicators at the local level.** Efforts to strengthen fiscal decentralization are hampered by limited data and information on the district development budgets, district level monitoring indicators; and M&E of development projects in districts. The capacity to collect and analyze data and information and to undertake M&E in districts is also limited. These shortcomings should be addressed by building capacity in the relevant agencies, with technical assistance being provided to the Planning and Development Department and to line departments.

Development Prospects and Risks

59. The central message of the report is unambiguous. The improved outcomes of the past few years indicate that there is considerable scope for accelerating development in the NWFP and for taking full advantage of the work ethic and enterprise of its citizens. It is the role of the provincial government to unleash this potential. The strategy advocated in this report focuses on: (i) expanding the private sector and the role of NGOs in the economy by implementing policies that are more supportive of the private sector policy and by reducing the presence of the public sector; and (ii) undertaking policy and institutional reforms to enhance growth and to improve public service delivery. Financing this higher growth strategy will require tapping a number of sources. On the fiscal side, it will require a higher level of transfers from the Federal government through a new NFC Award (expected to take effect from FY07), revised hydel payments, and increased efforts to mobilize own revenue by the province. The implementation of this strategy is also likely to be supported by foreign assistance on concessional terms from bilateral donors and from international financial institutions.