

## 7. SUMMARY AND CONCLUSIONS

**After a decade of moderate growth but little or no long term change in rural poverty in Pakistan, agricultural output, rural incomes, rural poverty and social welfare indicators all showed marked improvements between 2001-02 and 2004-05.** However, longer term trends suggest there is little reason for complacency. Some of the improvement in rural expenditures between 2001-02 and 2004-05 appear to reflect low levels of income related to drought and low levels of workers' remittances in 2001-02. The agricultural GDP per capita growth rate (1999-2000 to 2004-05) was only 0.3 percent per year; rural poverty rates in 2004-05 are still at levels that approximate those of the 1990s; and social welfare indicators in Pakistan remain significantly below those of other countries in south Asia. Moreover, problems related to timing and availability of water for irrigation, inadequate rural infrastructure, a skewed distribution of assets, and low levels of health and education continue to slow the progress of economic growth and poverty reduction.

### **RURAL POVERTY: STRUCTURE AND TRENDS**

**About two-thirds of Pakistan's population lives in rural areas (1998 census data), where average per capita expenditures are 31 percent lower than those in urban areas (Rs 1259/month and Rs 1818/month in 2004-05, respectively).** Rural, as well as total population growth rates are declining, which bodes well for future per capita income growth. Nonetheless, the rural population is likely to continue to grow, and may reach 122 million in 2015 (64 percent of the population) at historic rates of migration of 1.2 percent per year. Urban population would reach 70 million in the same time frame according to this scenario, and 82 million (43 percent of the population) if the net migration rate doubled to 2.4 percent per year.

**The majority of the rural poor in Pakistan are not farmers (neither tenants nor owners).** Farmers comprised only 35 percent of the households in the bottom 40 percent of rural per capita expenditure distribution. Non-farm households (not including agricultural laborer households) accounted for slightly over half (57 percent) of the poor in 2004-05. This distribution of rural poverty in large measure reflects the distribution of land, which is highly skewed in Pakistan. According to the 2000 Agricultural Census, only 37 percent of rural households owned land, and 61 percent of these land-owning households owned fewer than 5 acres, (15 percent of total land).<sup>90</sup>

**Because of the skewed distribution of land and agricultural income, as well as non-agricultural income's large share of total income for the rural poor, agricultural growth is not highly correlated with reductions in rural poverty.** During the 1970s and 1980s, agricultural growth was accompanied by substantial reductions in rural poverty, but rural poverty rates in Pakistan did not decline in the 1990s in spite of substantial growth in agricultural GDP. In

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<sup>90</sup> Pakistan has attempted to implement several land reforms (the most recent in the early 1970s) that faced substantial opposition and ultimately had only limited success. Sale or grants of government land to the poor are potential alternatives. Market-based land reform involving voluntary land sales is another alternative, but could involve large fiscal costs (See World Bank 2004b).

addition to skewed land distribution, possible overestimates of agricultural GDP growth and an increase in real consumer prices of major staples in the mid-1990s also contributed to stubbornly high rural poverty rates.

**Data from national household surveys indicate that real expenditures of the poorest 40 percent of households increased and rural poverty decreased between 2001-02 and 2004-05.**

However, comparing 2004-05 per capita expenditures with those in 1998-99, there was almost no change (only -0.2 percent) in real expenditures per capita of the poorest 40 percent of households. A decline in crop incomes due to drought in 2001-02 and then an increase in 2004-05 (in large part because of a record cotton crop following good weather) are in part responsible for the fall and subsequent rise in rural household incomes, particularly for cotton farmers. In addition, workers' remittances (some of which accrue directly to rural households), increased sharply from \$2.4 billion to \$4.2 billion over the three years, although as these have changed little between 2002-03 and 2004-05, further large increases seem unlikely. Finally, rural households also benefited from overall growth in the economy that spurred demand for construction and other labor-intensive services.

**Analysis of rural household panel data indicates that primary and secondary education, land ownership, village electrification and paved roads are all significant factors that determine changes in household welfare over time.** For example, the presence of an additional male with a secondary education in a household increases real expenditures (a measure of long-term incomes) by 10.2 percent, a magnitude approximately equivalent to owning five acres of land (a small farm by Pakistan standards). Econometric evidence also suggests substantial positive returns of education on income levels in rural Pakistan persist, even after taking into account innate cognitive ability, mainly due to higher productivity in non-farm activities.

**Social welfare indicators also showed improvement in 2004-05, but unlike income and expenditure-based measures, these gains appear to reflect permanent (structural), rather than transitory factors.** Urban residents fare much better than do rural residents, particularly with respect to access to tap water, adult literacy rates, and gross enrollment rates in primary school. All of these measures show consistent improvement for rural households in surveys from 1998-99, 2001-02 and 2004-05, though there remain large differences between males and females in terms of education and literacy. For example, gross enrollment rates for girls at primary school rose by 18 percentage points, from 50 percent in 1998-99 to 68 percent in 2004-05, but they remain 21 percentage points below those for boys (89 percent). Moreover, these gender gaps are declining only slowly: the gender gaps in gross enrollment rates at both the primary and middle school levels declined by only five percent between 1998-99 and 2004-05.

## **TOWARDS A STRATEGY FOR RURAL GROWTH AND POVERTY REDUCTION**

**Overcoming the constraints to rural income growth and poverty reduction in Pakistan will require a strategy that goes beyond agriculture, however, and for several reasons.** First, the rural economy involves much more than just agriculture and much of the gains made in agricultural production accrue to the non-poor. Agriculture accounts for only about 40 percent of rural household incomes (30 percent for the poorest 40 percent of rural households) and the majority of the rural poor in Pakistan are not farmers. Secondly, household welfare involves more than just income and Pakistan's rural poor are particularly disadvantaged in non-income measures of welfare. Third, poverty reduction is ultimately about people, not location or economic sectors. As in most of Asia, Pakistan's economy is in the midst of a major transformation characterized by growing urbanization and increased linkages among the rural, urban and international markets.

**Given this context, a comprehensive rural growth and poverty reduction strategy is needed, predicated on four main pillars:**

- Promoting efficient and sustainable **agricultural growth** to raise incomes of small farmers and to generate growth linkages in the rural non-farm economy.
- Creating an enabling environment for the **rural non-farm sector** to enhance employment and incomes, and improving **rural public-service delivery** in infrastructure, health, education and population to serve as a foundation for growth and to increase household welfare
- Improving the **effectiveness and governance of rural institutions** through the decentralization and strengthening of local demand for enhanced accountability as well as through more proactive use of public-private partnerships
- **Empowering the poor** and protecting the most vulnerable through social mobilization, safety nets and facilitating access to productive assets for income generating activities.

## **PROMOTING EFFICIENT AGRICULTURAL GROWTH**

**Annual agricultural growth in Pakistan averaged 3.7 percent over the four decades from 1959-60 to 2001-2002, due in large part to high growth in the crops sub sector in the 1970s and 1980s as a result of Green-Revolution technology (improved seeds, increased fertilizer use, and irrigation).** However, the performance of the agriculture sector (particularly the crops sub-sector), has suffered in recent years because of severe droughts, as well as environmental factors (increased soil salinity and deteriorating groundwater quality). From 1999-2000 to 2004-05, agricultural GDP grew at a modest 2.3 percent per year (only 0.3 percent per year on a per capita basis), in spite of a 7.5 percent growth from 2003-04 to 2004-05 due partly to a record cotton harvest. Total crop GDP grew by only 1.8 percent per year, mainly because of a 1.4 percent annual increase in crop GDP/hectare, while the total cropped area increased by only 0.4 percent per year. Livestock, which accounts for nearly half of agricultural GDP, grew by 3.0 percent per year.

**Four crops (wheat, cotton, basmati and ordinary rice, and sugar cane) accounted for roughly two-thirds (68 percent in 2002) of agricultural crop GDP and slightly more than one-third (34 percent) of total agricultural GDP in 2004-05.** Much of the focus of agricultural policy, research and extension has been on these crops, and adoption of Green-Revolution technology of improved seeds, increased fertilizer use and irrigation (especially private tube wells, which provide better water control) contributed to substantial increases in yield and production of wheat and rice. Comparatively little attention has been given to increasing livestock productivity, despite the sub sector's high share of total agricultural GDP.

**Although grain yields have continued to increase since the onset of the Green Revolution, further productivity increases are possible.** From 1990-91 to 2004-05, average growth in wheat, basmati rice and maize yields were 2.1, 3.73, and 3.95 percent, respectively. Cotton yields, by contrast, stagnated over this period, increasing by only 0.59 percent per year (although 2004-05 produced a bumper crop), and yields of sugar cane increased by only 0.91 percent per year. Past investments in agricultural crop technology (especially for cereals) have had very high payoffs in south Asia in terms of poverty reduction, both by raising farmers' incomes and by reducing real prices of major staples (wheat and rice). Further investments in agricultural technology, especially for the major cereals and cotton, (for which Pakistan has a comparative

advantage are needed to offset declining soil fertility in many regions as well as to increase productivity.

**Table 7.1. Summary of Suggested Policy Reforms for Accelerated Rural Growth and Poverty Reduction**

**Agriculture**

- Increase agricultural productivity
  - Maintain incentives for production of tradable agriculture
    - Avoid policy-induced appreciation of real exchange rates by liberalizing markets for foreign exchange and trade
  - Promote agricultural diversification through public-private partnerships in research and extension (Box 3.1) and marketing of high-value crops
  - Promote livestock development, particularly for smallholders
    - Increase research expenditures; promote competition in dairy marketing and in the supply of veterinary services (Box 3.3)
  
- Improve efficiency and sustainability of water use (Box 3.5)
  - Develop plans for **asset management** that include:
    - Measures for the divestiture by irrigation departments of some assets to the private sector or farmer organizations (FOs), whenever feasible
    - Detailed operation and maintenance plans, including cost-recovery mechanisms
  - Improve **service delivery** and **allocation of water** through strengthening of water users associations and FOs, and by giving FOs responsibility for collection of *abiana* and operation and maintenance at the distributary and branch canal level
  - Increase the **availability of water** through investment in storage and other structures after careful evaluation of environmental and social consequences
  - **Rationalize water use** and review water charges so that these better reflect opportunity costs of water usage
    - Begin to develop markets for entitlements to canal water by establishing legal tradable water rights at the national and provincial levels
  
- Improve efficiency of agricultural markets
  - Reduce government interventions and subsidies in wheat markets (Box 3.6)
    - Significantly lower volumes of public procurement by provincial food departments and PASSCO
    - Avoid domestic marketing and storage restrictions
    - Maintain a liberalized import policy
    - Increase transparency and consistency of government policies
  - Promote farmer associations to increase farmers' market power
  - Establish system to meet SPS standards (Box 3.2)

**Table 7.1: Summary of Suggested Policy Reforms for Accelerated Rural Growth and Poverty Reduction (cont.)**

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**Rural Non-Farm**

- Provide adequate rural infrastructure
  - Improve the quality of electricity supply and access to telecommunications services
  - Ensure adequate funding for maintenance and improvement of rural roads
  - Extend basic motorized access in rural areas where this is lacking
- Facilitate market linkages
  - Strengthen local business associations and facilitate group marketing and business clusters to link small-scale entrepreneurs to larger firms and markets
  - Enhance mechanisms for contract enforcement by promoting transparency in the legal system
- Increase access to credit
  - Continue liberalization of the banking sector and credit markets
  - Avoid use of subsidized credit through public banks
  - Promote use of alternative forms of collateral and more flexible loan repayment
  - Improve land titling through computerization and administrative reforms
  - Provide training programs in bookkeeping and business management

**Public Service Delivery**

- Increase flow of resources to local government for rural development
    - Monitor budgets and actual flows of revenue and expenditures for rural development, including flows to local government
    - Use block grant funding for equalization purposes and performance grants to reward good performance
    - Increase rural development expenditures (especially for health and education)
  - Improve administrative efficiency
    - Fill key administrative positions (especially finance and planning) with skilled staff
    - Provide training for local government officials (especially at the TMA level)
    - Clarify rules and procedures regarding funding for CCB projects (Box 5.2)
  - Enhance sustainability of RSPs
    - Improve coordination and begin integration of RSPs with local government
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**Table 7.1: Summary of Suggested Policy Reforms for Accelerated Rural Growth and Poverty Reduction (cont.)**

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**Improving the Effectiveness and Governance of Rural Institutions**

- Improve Governance and Accountability
    - Reduce the share of resources allocated to discretionary special programs
    - Publish and disseminate local, provincial and federal government plans and financial reports
    - Strengthen Monitoring Committees at local levels to assess performance and take actions
    - Enhance mechanisms for contract enforcement and promote transparency in the legal system
    - Strengthen monitoring and evaluation of rural development programs and trends
      - Establish up-front indicators, carry out baseline assessments and monitor performance of indicators against targets
      - Improve basic data collection (e.g. rural wage data)
  - Promote Public-Private Partnerships
    - Forge partnerships with the private sector to develop and disseminate new agricultural technologies
    - Strengthen engagement with private and NGO schools
    - Increase financial support to NGOs, including RSPs, for delivery of micro-credit, skills training and other private services
  - Increase accountability, efficiency, transparency and competition in surface water supply
    - Unbundle operations into bulk (operation of dams and barrages), transmission (canal management) and distribution (management of tertiary systems), with relations among the parts governed by contracts
    - Encourage private-sector involvement in management of canals and promote competition between irrigation departments and private service providers at the distributary level
  - Improve effectiveness of agricultural research (provincial level) and extension (provincial and local-government levels)
    - Create autonomous research organizations (provincial level)
    - Tailor research agendas to the needs of individual provinces
    - Increase the capacity of district governments to set priorities and develop implementation strategies for agricultural development
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**Table 7.1: Summary of Suggested Policy Reforms for Accelerated Rural Growth and Poverty Reduction (cont.)**

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**Empowering the Poor**

- Promote social mobilization
  - Initiate a social-mobilization program based on building social capital and promoting organizations and institutions of the poor
  - Facilitate access to productive assets by poor people through a matching grant window or the establishment of revolving funds at the community level
  - Strengthen Citizen Community Boards (Box 5.2)
    - Review and revise rules, procedures and partnership arrangements between government and CCBs
    - Establish a robust monitoring and evaluation system
    - Develop project standards and written agreements that clearly delineate responsibilities
    - Consider registering community organizations established by RSPs and other civil-society institutions such as Village Organizations and CCBs
  - Include social-mobilization components in the design and implementation of rural development programs (Boxes 6.3, 6.4 and 6.5)
- Increase efficiency of micro-finance programs
  - Focus on savings over loans and efficiency of saving services
  - Continue to adapt saving and lending instruments to client demand
  - Increase lending to women's groups
  - Link local informal financial institutions to formal institutions

**Social Protection**

- Increase coverage of social protection programs
    - Pilot a targeted conditional cash transfer and scale up school-feeding programs (Box 6.6)
    - Eliminate untargeted programs (e.g. wheat flour subsidies)
  - Address problems related to heavily-indebted labor
    - Increase public awareness of unfair labor practices
    - Strengthen enforcement of existing laws regarding bonded labor
    - Launch pilot project to provide access to credit and alternative income sources for heavily-indebted workers.
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**Achieving substantial growth in agricultural incomes in the future will also require greater diversification into higher-value crops that can maximize returns to scarce factors of production (land and water).** This will require greater investment in agricultural research on crops such as oilseeds, vegetables and fruits as well as livestock; better coordination with the private sector in the form of public-private partnerships; and improvements in seed certification and quality control. Sound macro-management will also be required to avoid an appreciation of the real exchange rate, which would not only reduce the incomes of wheat, cotton and rice farmers, but also reduce price incentives for producers of fruits, vegetables and other items for export.

**Programs to increase livestock production, especially of dairy cattle and milk in Punjab and Sindh, and sheep and goats in NWFP and Baluchistan, can have direct and significant impact on the incomes of the rural poor.** As livestock ownership is more evenly spread across rural households than is access to land, productivity gains in livestock are generally more pro-poor than productivity gains of major crops. Smallholder's gains are feasible through use of improved feeds, better veterinary services, and more efficient marketing channels to help ensure remunerative prices of milk for farmers. Designing an effective program will require special attention to cultural and economic constraints faced by rural women, who have a major role in the care of livestock.

#### **Water: The Key Resource Constraint**

**Increasing the efficiency of water use is critical for the sustainability of agriculture in Pakistan.** Water remains the key resource constraint in Pakistan agriculture. Irrigation water is critical for agriculture in most areas of the country and massive public investments in dams and canals in the Indus river basin, together with mainly private investment in wells for groundwater irrigation have been essential for agricultural production. However, current patterns of water use in Pakistan are causing significant environmental degradation: losses of soil fertility due to agricultural soil degradation (soil salinity and erosion) are estimated at Rs 70 billion per year (1.5 percent of total GDP and 6.8 percent of agricultural GDP, 2004-05 GDP estimates). In addition to environmental losses, inefficiencies in water allocation within canal systems result in lower crop productivity at both the head end (due to over-use of water and water-logging) and the tail end (due to water shortages) of canals.

**Increasing availability of surface irrigation water can only be a partial solution.** There is little storage capacity (downstream of the Mangla and Tarbela dams) in northern Punjab or water control in Pakistan's run of the river irrigation system. Adding storage capacity in the form of dams could in principle help improve water availability in the dry season by spreading out the flow of water over the year. Nonetheless, even if investments to increase storage are undertaken immediately, storage capacity will not increase within the next ten years, and will likely actually decrease somewhat in this period due to silting of existing facilities. In addition, there is also a need to improve drainage systems to reduce the salinity and water logging that occur in the Indus basin irrigation system.

**Improvements in water delivery** (including investments in drainage, control structures and conveyance mechanisms), **better water management** (through strengthening of water course organizations, farmer organizations, area water boards or professional canal management agencies) and **greater efficiency of water use at the farm level** (crop choice and adoption of water-saving technologies) are the most promising approaches in the short to medium term. **Irrigation Departments need to establish asset management plans** that indicate measures for divestment of assets to the private sector or farmer organizations, as well as operation and

maintenance plans that include medium-term expenditure frameworks, assignment of financial responsibilities to the various actors, pricing policies and cost-recovery mechanisms. **Service delivery and water allocation can be improved through promotion of water user associations (WUAs) and farmer organizations (FOs)**, as well as through improvements in the existing infrastructure. FOs could be given the authority to collect *abiana*, as well as operation and maintenance at the distributary and branch canal level.

**Financial incentives for efficient, sustainable and equitable water use can also help rationalize water use.** Given that water is increasingly scarce in Pakistan, a shift away from water-intensive crops like sugar cane to less water-intensive crops such as oilseeds (sunflower and canola), maize, and vegetables irrigated with drip irrigation techniques could result in large water savings, increasing water availability downstream and reducing environmental degradation. For example, shifting 60 percent of land cultivated with sugar cane to a maize-wheat rotation or about one-quarter of ordinary rice land to maize would save enough water to supply the current needs of Karachi.

**Charges for canal water (*abiana*) should be revised so that they better reflect opportunity costs of water usage and thus used as an incentive for farmers to diversify to higher value crops.** However, to minimize problems of non-payment, any increase in water charges would need to be accompanied by improvements in service delivery. Raising water charges to levels commensurate with the opportunity cost of water is likely to be politically infeasible, however. One alternative is the development of markets for tradable water rights such as exist in Chile and Mexico. This would require laws establishing tradable water rates and the strengthening of local institutions to enable them to serve as brokers in water markets. Projects and programs involving agricultural extension, technical assistance, market development and credit may be needed to ease the transition of farmers and processors to alternative crops and products.

### **Agricultural Markets and Trade Policies**

**Agricultural trade and pricing policies can also significantly affect producer incentives, but distortions to prices of most agricultural products in Pakistan are small.** Direct trade and pricing policy distortions, as measured by nominal rates of protection using official exchange rates, have generally declined in absolute magnitude since the early 1980s. Including the effects of exchange rate distortions, the pattern is clearer, with a sharp reduction in policy distortions over the past two decades. Significant trade taxes and restrictions on major agricultural products remain only for vegetable oil, powdered milk imports and basmati rice exports.

**However, the government continues to intervene heavily in wheat markets at high fiscal costs and generally little benefit to most producers or consumers.** Provincial governments (mainly Punjab and to a lesser extent Sindh) and PASSCO (Pakistan Agriculture Storage and Supplies Corporation) procure about 20 percent of total wheat production each year. On average, a similar amount is resold before the next harvest, ostensibly to prevent market manipulation by traders and millers and thus stabilize wheat market prices and supplies. One major effect of these interventions, however, is to crowd out private trade and storage. **Reducing the volume of domestic procurement (and subsequent intra-annual sales)** would directly reduce the wheat subsidy that arises from the difference between the sales price of government wheat (whether procured locally or domestically) to wheat mills and the full costs of procurement of wheat and handling. Maintaining incentives for private-sector trade through avoidance of restrictions on transport of grain (as were imposed by the government of Punjab in 2004), continued liberalization of private-sector imports, and transparent and consistent government policies can help stabilize prices and supplies, while lowering fiscal costs.

**Faster growth in exports of non-traditional agricultural products (fruits and vegetables, meat, fish) will require improved capacity to meet Sanitary and Phytosanitary (SPS) standards imposed by destination countries.** Pakistan presently lacks a coherent strategy (or set of strategies) for quality and SPS management in relation to its trade. Organizationally, there is a need to consolidate and augment the fragmented, isolated, and non-coordinated capacity of SPS management institutions and regulations by better defining roles and responsibilities of the various agencies involved in SPS management, strengthen technical capacity for risk assessment, and re-institutionalize early warning and surveillance systems for pests, diseases and contaminants.

## **THE RURAL NON-FARM SECTOR AND THE RURAL INVESTMENT CLIMATE**

**Agricultural growth is an important pathway out of poverty for the 40 percent of Pakistan's rural poor that are farmers; for the 45 percent of the rural poor who do not earn income from the crop sector, however, escaping poverty requires growth in rural non-farm incomes or out-migration.** Simulation analyses based on a 2001-02 Social Accounting Matrix (SAM) for Pakistan indicates that growth linkage effects ensuing from increases in traditional crop agriculture are likely to result in only relatively small gains in total rural non-farm incomes relative to the large size of this sector. As a result the average percentage increase in incomes of rural non-farm poor may likewise be small. For these households, a well-developed and well-functioning rural non-farm sector is essential for employment generation, ensuring income diversification and reducing poverty (World Bank 2004b).

**Results from a 2005 survey of 1651 entrepreneurs in rural villages and small towns<sup>91</sup> in Punjab, Sindh and NWFP indicate that finance is a major constraint on the growth of the rural non-farm enterprise sector.** More than 30 percent of enterprises surveyed rated access to finance as the most important overall constraint to the operation and growth of their business. There appears to be considerable unmet demand for formal credit; less than 20 percent of entrepreneurs that seek formal credit for start-up capital or investment purposes received credit. The major source of formal financing is from commercial banks, but access to these institutions is limited in rural villages; most small-town enterprises however are located in close proximity to a commercial bank. Only about one percent of start-up and working capital for rural and small town enterprises comes from formal banking sources.

**Even when entrepreneurs have physical access to commercial banks, they are constrained by an inability to provide sufficient collateral.** Eighty percent of approved loans required collateral. On average the value of collateral required for a loan was about 132 percent of the loan amount, making it difficult for households without substantial land or property to gain access to formal credit.

**While improving financial access for non-farm enterprises is important, survey findings also reveal that most rural enterprises are not able to put together a financial statement, and face problems in marketing their products and hence are probably unable to meet the expectations of financial institutions' due-diligence processes.** Therefore in addition to improving supply-side conditions, technical assistance in bookkeeping, documentation, training

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<sup>91</sup> Small towns are defined as town councils and municipal councils with populations less than 100,000.

in business management and entrepreneurial skills for rural enterprises would significantly improve their access to credit and overall business development. Although access to formal medium- to long-term financing is limited, Pakistan's non-farm enterprises seem to have comparatively better access to supplier credit. Traders are the main beneficiaries of supplier credit which is extremely short-term in nature (with a median loan term of 2 weeks).

**According to the survey, village enterprises were more affected by poor infrastructure than those located in small towns.** Road quality, availability of transport, and access to electricity also rank among the top constraints reported by village entrepreneurs. Quality and access to electricity were the major infrastructure problem cited by small-town businesses. Of the three provinces surveyed, villages in Sindh fared the worst in terms of road quality and availability of transport facilities for goods. Access to electricity remains a major challenge in many rural villages and small towns, and even among enterprises with access, reliability of supply is uncertain. The median number of power outage days in a typical month were reported as 20 in villages and 15 in small towns. Frequent outages increase production costs and generators are usually unaffordable for small businesses. Only five percent of village enterprises and around seven percent of small town enterprises reported owning or sharing a generator. Power outages are particularly costly for manufacturing enterprises. While small-town and village entrepreneurs surveyed did not complain much about telecommunications, access to and use of telecommunications among enterprises is surprisingly low, particularly considering that close to 60 percent of the enterprises were traders. Only 31 percent of entrepreneurs in small towns owned fixed line phones or cellular phones; the comparable figure in villages is nine percent.

**Relatively few firms cited as a constraint governance issues.** This differs significantly from the findings of the 2003 urban ICA, in which 40 percent of businesses rated corruption as a major or severe constraint. There are however regional differences. Firms located in small towns of Punjab were more likely to complain of policy uncertainty and those in small towns in Sindh were more likely to cite problems with crime and corruption. Overall however, less than three percent of approximately 900 firms reported the need to pay an illegal fee. Although few firms mention crime or corruption, contract enforcement and confidence in the legal system remain a concern for many enterprises, particularly in Sindh.

**As close to half of all rural households in Pakistan are primarily non-farm households and thus heavily dependent on non-agricultural incomes, attention to the constraints facing small-town and village entrepreneurs will be necessary to ensure that this sector is able to grow and generate more employment.** Doing so will require a combination of investments, improvements in service delivery and policy reforms. Technical assistance in the forms of business development services and strengthening local business organizations would also be beneficial. Overall improvements in human-resource development and greater levels of literacy are also needed as the survey data clearly indicate that firms with more educated managers are more likely to innovate and tap into business networks and consistently seem to perform better.

## **IMPROVING PUBLIC SERVICE DELIVERY**

**Provision of basic rural infrastructure and delivery of basic public services such as water supply, sanitation and roads, is crucial for rural economic growth and improved welfare of the rural poor.** Pakistan's devolution program, begun in 2002, was designed to improve public-service delivery by increasing the decision-making and implementation authority of local governments and augmenting their fiscal resources. Evidence from case studies in eight districts

in Punjab, Sindh and NWFP suggests that devolution has been broadly successful in achieving these goals, though more remains to be done even in the most successful cases.

**Fiscal resources for rural development have increased at the federal and provincial levels since 2001-02; changes in the level of resources at the district levels vary by province.** From 2001-02 to 2005-06, total consolidated expenditures (fiscal and provincial), government revenues and the budget deficit all increased by 23 to 26 percent in real terms. A large share of these additional resources was devoted to development expenditures, which increased by 85 percent (18.1 percent per year), reflecting the government's commitment to development investments. Growth in development expenditure was particularly rapid at the provincial level (48.8 percent per year) as compared to the federal level (10.6 percent per year). Total transfers to local government (districts, *tehsils* and unions) varied by province, however. Average transfers to local governments in Sindh in 2004-05 and 2005-06 were 50 percent higher in real terms than the average of 2002-03 and 2003-04; in Punjab and NWFP, by contrast, there was essentially no change over time. It is noteworthy that large increases in expenditure for health and education at the district level are not shown in these budgets, however.

**Resources vary enormously across districts, *tehsils* and villages.** In a survey of seven districts in Punjab, Sindh and NWFP, availability of resources per capita ranged from 981 Rs/person in Sargodha (Punjab) to 2000 Rs/person in Chakwal, also in Punjab. On average, current expenditure accounted for 80 percent of total expenditure (salaries alone accounted for 63 percent) and the share of resources devoted to development expenditures nevertheless ranged from 3-35 percent. **Even wider variation in fiscal resources is found at the TMA level, with** expenditure per capita more than eight times as high in Digri (381 Rs/person) and Khairpur (361 Rs/person) as in Timergarah and Samarbagh of NWFP (both 44 Rs/person). In part, this difference in resources reflects a greater ability of some *tehsils* to raise their own revenues through local taxes and fees; district awards to *tehsils* also vary, from only 11 Rs/capita in the two NWFP *tehsils* sampled to 240 Rs/capita in Khairpur.

**Even five years after devolution, confusion remains over the roles and responsibilities of the various levels of government, as well as apparent jurisdictional overlaps.** Staff shortages and lack of appropriate skills are also serious constraints to efficient service delivery, particularly at the TMA level. Moreover, the transfer of resources through the vertical programs and other higher-level government programs adversely affects local governments' autonomy in preparing development budgets as well as undermining accountability and operational efficiency. Substantial resources are allocated, especially in the water and sanitation sector, through Members of the National Assembly (MNAs), Members of Provincial Assemblies (MPAs) and directives of the Chief Minister.

**The delegation of power to local governments through devolution has brought decision making closer to the communities and allowed them to access government officials and there has been some improvement in service delivery.** As reported by all 14 *tehsils* surveyed (except Bahawalpur) citizens' degree of access to their representatives has increased considerably and problems are solved relatively quickly under the new system. Priorities of the local communities are also increasingly reflected in development schemes. However, the performance of Citizen Community Boards (CCBs) in terms of their financial contribution as a percentage of government financing of development expenditures at the district level varies substantially, from only 2-6 percent in the three districts of Sindh sampled to 22-34 percent in the three Punjab districts.

## IMPROVING THE EFFECTIVENESS AND GOVERNANCE OF RURAL INSTITUTIONS

**Devolution in 2002 was an important step toward a more decentralized, efficient and demand-driven government in Pakistan.** In addition to increasing resources for local government and improving its administrative capacity, other measures are needed to improve the effectiveness and governance of rural institutions. Greater interaction between private-sector groups and farmers in the form of public-private partnerships could facilitate government responsiveness and improve efficiency of investments and programs. Measures that improve governance and accountability such as stricter enforcement of laws, reforms in the legal system and wider dissemination of information on spending and effectiveness of programs would also help spur both greater efficiency of government, as well as growth and investment in the private sector.

**Public-private partnerships (PPPs) should be pursued aggressively in agricultural marketing, research and extension, health, education, infrastructure and other sectors to enhance productivity of public-sector programs.** An incentive structure should be put in place to encourage the private sector to enter into contractual arrangements with farmer organizations and link delivery of public services to business development. Public-private partnerships in agricultural research and extension would encourage public research systems to become more responsive to farmers' actual needs. Recent education sector reforms undertaken by the government should be strengthened to enable engagement with private and NGO schools to improve access and quality of education, including government-supported per child subsidies. Finally, government financial support could be increased for NGOs, including Rural Support Programmes for delivery of micro-credit, skills training and other private services.

**Improving governance is crucial for reducing poverty and promoting growth in both the farm and non-farm sector.** Governance issues, including political instability, corruption, insecurity and lingering conflicts, are a major drag on investment, economic growth and efforts to reduce poverty. Bureaucracies with low accountability to stakeholders give rise to inefficiency and shortfalls in delivering rural services. To overcome these challenges, the government should strengthen efforts begun in recent years to: i) reform government institutions related to economic and financial management, the police, the judicial system, and the civil service; (ii) improve public financial management, accountability, and increased transparency and information on government activities to facilitate public oversight; (iii) strengthen local government institutions; and (iv) privatize and deregulate public enterprises to reduce opportunities for rent-seeking behavior.

**Monitoring and evaluation within a national and results-based management framework is increasingly important with burgeoning CDD and microfinance programs as there is greater uncertainty about what will work than in traditional projects.** There is a need for up-front poverty indicators and simple baseline assessments and ongoing monitoring of indicators against targets. Although "better M&E" is so often mentioned as to be almost a clichéd recommendation, the increase in CDD projects and microfinance, which by their nature are uncertain and require rapid management reactions, effective M&E with a poverty impact focus becomes much more important.

## EMPOWERING THE POOR AND PROTECTING THE MOST VULNERABLE

Increasing the flow of resources to local governments and improving administrative procedures addresses mainly the **supply of public services**. Improving the effectiveness of development programs requires more **effective demand for public services**, as well. In addition, although inclusive economic growth should be the main mechanism for reducing poverty, increased **social protection** efforts are needed to protect the most vulnerable.

**A major reason for the limited impact of rural development efforts in Pakistan and many other countries is a lack of effective participation and influence of rural poor households in development programs and rural society.** Too often, a top-down approach has been implemented, one in which the rural poor are simply beneficiaries of public programs supplied by the government. Rather, the development paradigm should put the household and the community at the origin of development initiatives. Empowering the rural poor to take on this role, however, requires social mobilization, a central pillar of the government's Mid-Term Development Framework (2005-10).

**Social mobilization can be defined as the enhancement of the community's capacity for collective action for its own betterment.** Together with economic empowerment and graduation, it should be at the heart of the rural livelihood development strategy. Mobilizing the poor, a major component of Pakistan's Rural Support Programmes (RSPs), provides them with the voice and the scale required to more effectively engage with the range of institutions and individuals that provide public and private services. Economic empowerment, e.g. through micro-credit or skills training, facilitates access to assets, increases incomes, and demonstrates the creditworthiness of individuals and groups. Ultimately these self-help groups may graduate to form other federative and associative movements involved in income-earning activities such as: public-private partnerships, various types of franchising and contract farming arrangements.

**Social-mobilization components have been incorporated into various rural development projects and programs, often together with micro-credit and public investment under the broad rubric of community-driven development (CDD).** In principle, governments may be best suited for delivery of public goods and services (and the investments required to support these) and the private sector and NGOs best suited for delivery of private goods and services (including micro-credit and skills training). However, the best institutional pathway to promote active community participation and their linkages with both public and private sectors is debatable, and depends on the particular characteristics of communities, government institutions and development constraints.

**In areas where local government institutions are still unable to effectively deliver public services, direct interventions through community organizations and NGOs are still necessary.** These programs work best where there are existing strong community groups; rural micro-level infrastructure and public health are especially important in isolated areas. **To ensure long-term sustainability, however, it is important that these efforts do not undermine efforts intended to strengthen local government institutions.**

**Microfinance programs, typically run through NGOs, including the Pakistan Poverty Alleviation Fund (PPAF), also channel money to rural areas, although this is mainly to individual households and enterprises.** Global experience with microfinance suggests a number of relevant lessons for Pakistan, such as: (i) the need to focus on *savings* and the efficiency of savings services as these may be even more important for the poor than credit, and micro-credit

without savings institutions is likely unsustainable; (ii) the need to continually assess product *demand* and to design savings and lending products to meet that demand (informal lenders, and even the staff of credit institutions themselves, have been able to develop suitable products); (iii) the exceptional qualified success with lending to women (the majority of sustainable loan initiatives worldwide have involved women) suggests that the *comparative* advantage within the household may be large, although socially acceptable mechanisms to lend to women may differ across localities; and, (iv) the importance of finding efficient ways of linking local informal rural finance institutions to formal institutions.

**Greater efforts need to be made to protect the most vulnerable households and individuals, as well.** Safety net programs to supplement the incomes of the poorest households remain very limited, particularly in rural areas. The largest program, *Zakat*, is financed through a voluntary levy of 2.5 percent of the value of financial assets deducted once a year and covers 1.733 million beneficiaries at a total cost of Rs 5.86 billion. The *Pakistan Bait-ul-Mal*, a Federal government agency that delivers vertical social welfare programs financed from general revenues, includes the Food Support Program, which delivers Rs 4.5 billion cash transfers to 1.25 million beneficiaries. Together with the *Tawana* Pakistan program that provides mid-day meals to 530,000 girls in government rural primary schools at an annual cost of Rs 0.70 billion, these safety net schemes total only Rs 11.1 billion, 0.23 percent of GDP. The other major social assistance program, the wheat subsidy, costs Rs 8 billion, is untargeted and is unlikely to provide much benefit to poor rural households, except to the extent that net wheat sales from public sector imports and drawdown of government stocks lower market prices.

**Safety nets for both the rural and urban poor should be made more efficient and scaled up to cover all ultra-poor households and some poor households (4-11 million households), largely through increased use of conditional cash transfers.** The wheat subsidy program could be replaced by a food- or cash-based targeted program. Cash transfer programs such as the Food Support Program can be scaled up and the scope of these programs widened to encourage long-term human capital investments among the poor, for example based on the pilot of the Child Support Program. The *Tawana* Pakistan school feeding program should, similarly, be redesigned and scaled up. Nutritional interventions aimed at improving health and nutrition of women and infants ought to be piloted and scaled up. The government could also consider piloting a major rural workfare program in order to provide temporary employment for vulnerable households. Programs are also needed to address the problem of heavily-indebted laborers, which persists particularly among landless sharecroppers in rural areas of southern Punjab and northern Sindh.

## CONCLUSIONS

**Many of the constraints on the efficient use of resources, economic growth and poverty reduction discussed in this report have long been recognized: inefficient water usage, unequal distribution of land and incomes, low levels of infrastructure and delivery of public services.** Several factors have changed, however. Environmental degradation has become increasingly serious, as has competition for rural and urban water uses. Agriculture's share of the overall economy has declined and the rural economy has become more closely integrated with urban and international economies. The latter two factors, along with the highly skewed distribution of land, offset but do not eliminate the impact of agricultural growth on rural poverty.

**Nonetheless, Pakistan has made important strides in the last several years in promoting rural growth and poverty reduction.** There has been substantial progress in liberalizing agricultural markets, promoting diversification and exports, and increasing expenditures on

infrastructure and public services in rural areas. Progress has also been made in empowering the poor through social mobilization (Rural Support Programmes and the creation of CCBs) and microfinance (the Pakistan Poverty Alleviation Fund). These efforts should be continued and strengthened. In addition, rapid and sustained reduction of rural poverty will require an even greater focus on building human capital (through improved delivery of health services and sanitation, basic education and appropriate technical training).

**Moving forward, it will be crucial to maintain a multi-faceted approach to rural development and poverty reduction and to ensure that sufficient resources are invested in the task.** Efficient agricultural growth is a necessary condition for robust rural economic growth, but in and of itself cannot be expected to drive substantial reductions in rural poverty in light of the highly unequal distribution of access to land and water resources in Pakistan. Thus, policies to promote agricultural growth must be complemented by investment and policies that create an enabling environment for the rural non-farm sector, including increased public investment in rural and small-town infrastructure. This will require shoring up the effectiveness and governance of rural institutions through decentralization, strengthening local demand for public services and public-private partnerships. Finally, because the ultimate objective of any poverty reduction strategy is to increase the welfare of the poor, health and education programs that promote the human capital of the rural poor, social mobilization that empowers and social protection programs that protect the most vulnerable should all receive increased resources and attention.