

## 5. Policy Implications: Recent Experience and Future Priorities

5.1 The analysis in this report highlights three critical areas of intervention that need to be the foci of poverty reduction strategies for Pakistan. The crosscutting theme of social protection is vital to mitigate the vulnerability, which, as shown in Chapter 2, affects a large share of households in rural and urban areas alike. As detailed across the report, this is a major reason for the persistence of observed poverty in Pakistan through the 1990s. And as noted in Chapter 3, this phenomenon is in turn closely linked to Pakistan's persistent and on many fronts widening social gap, particularly in education and health. Hence the importance of strategies to improve human development indicators. Given the significant gap between urban and rural indicators, the high rural incidence of vulnerability – attributable largely to recurrent weather related shocks in 2000 and 2001 – and the fact that two thirds of Pakistan's poor are concentrated in the rural areas, this chapter also devotes special attention to the need for a well-coordinated rural strategy. As discussed in Chapter 4, this should address both the need for social protection and human development as well as other issues specific to rural poverty such as asset ownership and agricultural resource management.

5.2 It is important to note that these strategies are premised on a broader developmental commitment by the Pakistani government to continue supporting and promoting macroeconomic stability and a governance environment that is conducive to private sector investment and growth. In this sense, the three pronged poverty strategy outlined in this report constitutes a mechanism to enable economic growth to be both sustainable and pro-poor by addressing the structural and sectoral constraints that have undermined long-term growth and have reduced its impact on poverty reduction.

5.3 To this end Chapter Five takes as its starting reference the Pakistani government's own Interim Poverty Reduction Strategy (I-PRSP) and bases its recommendations on the experience of existing programs and initiatives in Pakistan and ways in which they can be leveraged in the future. A review of such programs highlights some positive experiences but also points to the need for substantial improvement and additional effort in many areas. Broadly, the ensuing recommendations emphasize common themes: improving access to markets for credit that mitigate vulnerability; removing institutional obstacles to service delivery which is particularly topical in the context of Pakistan's recent devolution reforms; improving access to assets, including land, in the rural sector; and improving coordination among mutually reinforcing policies. The importance of improving monitoring of program results is also emphasized.

5.4 Encouragingly, the recommendations that derive from the analysis in the report are broadly consistent with the strategy outlined in Pakistan's I-PRSP (Box 5.1), though they also suggest a need for a strengthening of this strategy. Key elements of the I-PRSP's recommendations are to promote growth through macroeconomic stabilization and by improving the investment climate for private sector led growth. Special attention is also paid to specific reforms in the rural sector, and to facilitate productivity and growth of small and medium enterprises. An additional important feature of this strategy is to lay out a plan that uses the ongoing process of devolution to enhance efficiency and quality of public services, particularly in education and health. While this focus of the I-PRSP is critical, there is a need to deepen the understanding that underpins some areas of reform identified in this chapter. Moreover, the chapter identifies some possible areas of intervention for which the I-PRSP has not laid out a detailed approach, for instance in the rural sector.

#### Box 5.1: Pakistan's Interim Poverty Reduction Strategy Paper (I-PRSP)

Pakistan's I-PRSP specifies five main goals of policy in the years ahead: engendering growth, reforming governance, creating income generating opportunities (specifically for the poor), improving human development, and reducing vulnerability to shocks (at the microeconomic level). Faster growth is to be pursued through a combination of prudent macroeconomic management, coupled with appropriate sectoral policies. The macroeconomic agenda stresses the importance of increasing tax revenue in order to provide more fiscal space for poverty reduction initiatives, while also overcoming Pakistan's adverse debt dynamics. Export growth is similarly recognized as vital to improving the external debt situation. Key sectors addressed include agriculture, small and medium enterprises (SMEs), the financial sector, infrastructure, energy, oil and gas, and telecoms. The I-PRSP argues that implementation of the government's devolution strategy holds the promise of a "grass-roots" transformation of Pakistan's politics, and better citizen oversight of government programs. It envisages providing income-generating opportunities for the poor primarily through a housing program, the distribution of government-owned land to the poor, and improved access to microcredit. The human development strategy presents an integrated framework to address the critical bottlenecks in service delivery, especially in health and education, and describes the ongoing devolution plan as the major policy reform geared to this end. As gender disparities remain substantial in all social indicators, targeted programs are considered essential to reduce these gaps, e.g., through subsidies for girls' education, and through programs like the Lady Health Workers Program and Women's Health Project. Shocks are to be better dealt with by revamping the *Zakat* system, revitalizing the food support program, and expanding the Khushal Pakistan Program. The I-PRSP also envisages institutionalizing mechanisms to track poverty-related expenditures and monitor intermediate variables as well as outcomes. The I-PRSP does not discuss whether the program is consistent with achievement of the Millennium Development Goals for the year 2015, although a casual impression is that it would indeed put Pakistan on the road to achieving the goals. The government of Pakistan intends to address this issue in the final PRSP that is to be prepared over the coming months.

5.5 In addition to the critical areas of focus covered by this report and Pakistan's I-PRSP, it will also be necessary to formulate policies that address the specific nature of urban poverty, and to collect additional information and research to underpin this work. For lack of such information, this chapter covers this issue mainly in the cross-sectoral context of social protection strategies to manage risk. Yet it is clearly informed by underlying dynamics requiring more attention. Chapter 2 finds that while some amount of poverty reduction has occurred in urban areas due to income growth, the growth would have had a much greater impact on poverty absent the considerable increase in inequality that has been observed. Achieving poverty reduction in this context will require an integrated approach that combines strategies that help manage and cope with risk, with broad-based policies that generate employment and raise incomes.

5.6 Important outstanding issues surrounding the nature and determinants of urban poverty include identifying precisely the main sources of growth in urban areas, the extent to which this growth has been distributed across sectors, and the factors that account for rising inequality. Existing information base is insufficient for such analysis, particularly in regards to the constraints faced by the informal sector, where most of the urban poor are concentrated. Survey efforts are underway to explore the business climate in urban Pakistan for formal sector firms, which will deepen the understanding of investment climate and constraints to employment generation in urban areas. This should be complemented by a study with poverty focus, looking into enterprises in the informal sector and identifying the range of factors that act as constraints to their productivity and incomes.

5.7 It is of course also true that a sustainable poverty reduction strategy for Pakistan must also incorporate an explicit plan of monitoring of poverty outcomes, both in the short and long term. This will enable policy makers to improve their strategy and implementation in accordance with actual performance. Moreover, monitoring will be important in the context of the internationally adopted Millennium Development Goals (MDGs), in terms of aligning the set of targets that it specifies for Pakistan with what is feasible, and by enabling continuous evaluation of progress towards these identified goals. While the I-PRSP lays out a monitoring plan for Pakistan, implementation of this plan will require formalizing its processes – a task for which building institutional capacity will play a critical part. Box 5.2 outlines some of the key issues that need to be addressed to ensure effective monitoring.

### **Box 5.2: Poverty Monitoring and Tracking of Progress towards the Millennium Development Goals**

The I-PRSP for Pakistan provides an elaborate framework for monitoring poverty, outlining the various data and technical issues surrounding the choice of indicators to track progress on poverty alleviation, as well as the output indicators that would provide continuous feedback to policy makers in the progress being made to realize the MDGs. The latter is especially useful to identify bottlenecks, set priorities, and reorient strategies to reach the target goals (see Tables A-5.1 and A-5.2 in Annex).

The implementation of the monitoring effort is under way and a few key issues are being addressed:

- Setting baselines and targets for long term poverty indicators: While Pakistan has a good household survey that can provide the basis for tracking long term indicators associated with poverty, in some cases, like education, where there is more than one data base, there is need to reconcile baseline information. This will be crucial for tracking progress in a consistent manner
- Setting an Official Poverty Line: Pakistan is one of very few countries in South Asia with no official poverty line, which is an essential issue to resolve. A regional workshop sponsored by World Bank and Pakistan Institute for Development Economics has helped in building consensus, which should result in the selection of an official poverty line
- Setting Provincial targets and goals: Given the inter provincial disparities in poverty and its associated indicators, the exercise of setting credible targets for individual provinces is an outstanding challenge. This can only evolve as the process of devolution gets fully implemented.
- Monitoring output indicators: Tracking progress over shorter spans of time is crucial especially for service delivery and targeted poverty programs. Triangulation with the expenditure tracking exercise will provide a quick and effective diagnosis of progress in these areas. World Bank and DFID are working with the Government to launch this effort by June 2002.

## **Social Protection – Managing Risk and Reducing Vulnerability**

5.8 As detailed in Chapter 2, 56% of households sampled in the IFPRI panel are vulnerable to falling into poverty due to weather-related shocks alone – evidence that suggests vulnerability is widely prevalent in Pakistan. The inability to mitigate risk can also lead to “costly” adjustments in behavior, for instance prompting enterprises to adopt less risky technologies, which might also provide lower returns. Since poverty and vulnerability are closely linked and reinforce each other, the policy responses to them can overlap and also have important synergies.

5.9 Credit and insurance are important ways of mitigating and coping with risk, but in Pakistan like most other developing countries, formal markets for these instruments are either completely absent or inaccessible to the poor. Microfinance provides an alternative means of extending such financial services to the poor. In addition it is important to enable the poor to cope with the impact of a shock after it has occurred, because many of the myriad risks to which they are exposed are difficult to eliminate entirely. Means to this end include social assistance, public works and cash transfers. Such measures, if they are viewed by poor households as being credible in terms of availability during times of need can also serve as valuable tools of risk-mitigation. Lastly, because access to urban housing is an important determinant of urban poverty and vulnerability, programs that promote access to this asset are also important.

5.10 Pakistan as a developing country lacks not only the resources, but also the institutions necessary to provide universal, formal safety nets, like unemployment and health benefits and insurance, social security, and pensions, to the large sections of the population that need them. While building such coverage may be desirable in the longer term, the strategy for the immediate future has therefore also to focus on existing programs. These include public works, targeted assistance initiatives, and programs that involve the use of informal community-based institutions. The following section assesses the specific

roles played by major existing programs of this kind, highlighting positive attributes and lessons for future policy, in addition to pointing up shortcomings requiring reform, or additional efforts.

5.11 As noted earlier, an underlying theme of this assessment is the need for greater complementarity among programs, and for underlying reforms in administration and governance. Existing Zakat, social pension and public works programs should consider expanding coverage and improving their responsiveness and flexibility, in part through better targeting. This also requires institutional reform, greater transparency, and in some cases, stronger government commitments. A review of microfinance programs suggests that it would be beneficial to expand coverage, deepen alliances with formal market institutions such as banks, and regularize public support for some programs. With regards to urban housing, the record points to the benefits of greater community participation in leveraging limited resources, and the importance of such programs being complemented by income support and credit access schemes.

### *Social Welfare and Pension Systems*

5.12 The following section reviews the current range of disparate programs in Pakistan that provide elements of social protection. The most important of these is the Zakat system, which is the principal form of cash transfers to the poor in Pakistan - an important form of social assistance that helps them manage risk. The publicly administered Zakat system is funded by a wealth tax and disbursed to institutions operating at the national level, with the remainder divided among local committees for disbursement to individuals. Those eligible to receive Zakat include the poor, especially widows and orphans, and the handicapped. At present, annual Zakat collection is around Rs. 5 billion, with about 2.5 million beneficiaries during 2000-01. Yet although Zakat has emerged as the government's main social safety instrument, its potential and scope in fighting poverty is yet to be fully realized.

5.13 Zakat has several positive design elements: its subsistence allowance seems adequate, amounting to about three times the average income gap of the poor;<sup>1</sup> its reliance on a specific source for funds ensures sustainability; and the program has a strong re-distributive potential. However, studies have found the impact of Zakat funds on the poor to be very limited, mainly because of the relatively small amount of aggregate transfers. Zakat collections as a proportion of GDP amounted to only 0.2 percent by 1992-93, implying that even if all the benefits had gone to the lowest quintile of households, the income of this group would have been augmented by only 2 percent.<sup>2</sup> In 1996-97, according to HIES data, only 3.5, 2.1 and 1.4 percent of households in the first, second and third lowest expenditure deciles respectively reported receiving any Zakat transfers. However, the limited aggregate impact of Zakat on poverty does not preclude a more significant impact on vulnerability, if the cash transfers were to help households smooth consumption in the face of shocks. Existing studies offer little insight into the consumption-smoothing aspect of Zakat – a major gap in assessing the program's impact that should be addressed by future evaluations.

5.14 The impact of Zakat transfers on poverty and vulnerability alike would also depend to a large extent on targeting efficiency. Evidence on this has been mixed at best. According to some studies, only about half of all direct payments went to households in the lowest expenditure quintile.<sup>3</sup> One of the reasons for this inefficiency is the problem in identifying eligible beneficiaries, which appears to be exacerbated by patronage politics at the level of the local Zakat committees. In addition, the status of beneficiaries is not kept up-to-date. Accordingly, beneficiaries may continue to receive support for years after their initial entry into the program, regardless of their current status.<sup>4</sup>

5.15 Encouragingly, the system of collection and disbursement of Zakat has been recently reorganized to improve its efficacy.<sup>5</sup> The institutional framework for implementing, monitoring, and evaluating the program is being strengthened, and relief to beneficiaries in the form of subsistence grants were raised

last year from a monthly transfer of Rs. 300 to Rs. 500. The government expects that an additional 1.5 million beneficiaries will be added to the current list of around 2.5 million Zakat recipients. Moreover, the revitalized Zakat system will provide funds not only to fulfill basic needs but also to permanently rehabilitate beneficiaries, by assisting in the establishment of small-scale commerce or other means of living suitable to their qualifications, skills profile, and local conditions.

5.16 Pakistan Bait-ul-Maal (PBM) is another notable safety net program, mainly providing assistance to those in need, like minorities, who are not covered by Zakat. Administered by an autonomous board of management, PBM provides two main benefits – the Individual Financial Assistance scheme that disbursed Rs. 14 million to about 5,000 beneficiaries, and the Atta Subsidy Scheme that provided about 200,000 families with a monthly cash stipend of Rs. 200 in 1997-98. However, limited coverage severely limits the impact of PBM, as does the tedious procedure involved in applying for assistance from this program. And unlike Zakat, Bait-ul-Maal does not have any identifiable source of income, so that its exclusive reliance on budgetary support leaves it vulnerable to changing fiscal conditions. From recent reports, it also appears that transparency is a serious problem, on account of the discretion that high-level functionaries have in allocating funds from this program.

5.17 For both the Zakat and PBM programs to fulfill their potential as safety nets, institutional arrangements must be strengthened for the identification of eligible persons, while making this process more transparent and simple. The risk-mitigating benefits of such programs could also be enhanced not only by improving targeting, but also by making the programs flexible enough to respond in a timely manner to the incidence of shocks, especially those of a covariant type. In addition, as far as individual programs are concerned, Zakat will benefit greatly from improvements in the assessment and collection of taxes, and the Bait-ul-Maal from a strong financial commitment from the government, along with improved financial management and planning.

5.18 Employees Old-Age Benefits Institution (EOBI) is the primary public social security scheme for low-income urban workers in Pakistan, providing pensions to workers earning less than Rs. 3000 a month in enterprises with 10 or more employees. Anyone who has worked for at least 15 years and is 60 years of age (55 for women) is eligible for a monthly pension, provided the employer makes periodic EOBI contributions (at 5 percent of wages) for their registered workers. There is also provision for a reduced pension for workers who retire before the age of 60, a pension for invalids for the duration of the illness, a survivor's pension and old age grants.<sup>6</sup> Given the rapidly expanding labor force and the large proportion of young workers, a scheme like EOBI has the potential to develop as a major safety net for low income, retired or invalid workers.

5.19 However, while limiting the coverage to workers below a threshold wage has enhanced targeting efficiency of EOBI, the program suffers from low coverage. The 1.2 million registered workers make up only 20 percent of the number of urban employees, partly because of the large number of workers employed in the informal sector and partly because of large scale evasion by employers. In addition, the fact that the employer contribution system adds to the cost of hiring labor may have an adverse effect on employment. Introducing a flat rate contribution per worker by the employer and by guaranteeing a matching contribution by the government may help address this problem, while also ensuring financial sustainability. It may also be beneficial to encourage contribution by the employees themselves. The scheme should also be expanded to include the self-employed and employees in firms with less than 10 workers (thus incorporating the informal sector), for which again it will be imperative to create correct incentives.

5.20 In addition to their functional shortcomings, there is also generally very little evidence about the impact of any of the programs described so far, in terms of reducing income or consumption volatility. This prevents an evaluation of their effectiveness as instruments for managing risk. In order to address

this gap in knowledge, analysis focused on the risk benefits provided by each program should be a priority for the future, and should underpin strategies that aim to expand their efficacy as risk management tools.

### *Public Works Programs*

5.21 As the discussion above has shown, existing social protection programs in Pakistan are insufficient to meet the need for social safety evinced by a large proportion of the vulnerable population. Public works programs, however, have typically played an important role as safety nets in many developing countries by conferring stabilization benefits by smoothing consumption in periods of high unemployment. While such programs have largely failed in Pakistan, for various reasons<sup>7</sup>, the government has clearly recognized the need for a functional public works program, and through an ongoing initiative named Khushal Pakistan Program - established a broad-based scheme that has the potential to significantly extend the coverage of social protection in the country.

5.22 Khushal Pakistan: Under this program, funds are allocated to districts through provincial governments, while the schemes are identified and selected at the district level through active community participation. The criteria are that a project should be capable of integrating with existing infrastructure, and that its management and implementation will be undertaken by a partnership with local beneficiary communities. According to the government, the program has created numerous employment opportunities and is providing essential infrastructure in rural and low-income urban areas. The program received an allocation of Rs. 7.5 billion during 2001-02, which has been adjusted in accordance with the rate of utilization experienced last year. With the expected improvement of district governments envisaged through Pakistan's recent devolution reforms, the government expects the program to enjoy greater local ownership and to gain in importance.<sup>8</sup>

5.23 While systematic evaluations of the Khushal Pakistan program would be possible only after it has been in operation for some time, there are some critical aspects of its design and implementation that need to be considered if it is to attain its social protection objectives. One concerns targeting. A public works program can achieve targeting efficiency through geographic targeting of areas with vulnerable population and also by inducing self-selection by intended beneficiaries, in which case its wages should be no higher than the market wage for the relevant type of labor. Wage schedules also need to be gender-neutral, and to this end, certain kinds of wage structures (like piece wages) can facilitate participation of women. Another critical aspect relates directly to the risk mitigation benefits provided by the program. Such benefits tend to be high when access to the program is viewed as credible during times of need.<sup>9</sup> Making Khushal Pakistan available at all times, and expanding it automatically during crises such as droughts and floods in affected areas, will accordingly maximize its risk mitigating qualities.<sup>10</sup>

5.24 Experience in other countries has also shown that delivery of benefits, as well as cost-effectiveness, can be enhanced by effective organization at the local level, by strengthening local governments, by building their capacity, and by ensuring incentive compatibility between local officials and line agencies. Facilitating empowering coalitions of the poor, like labor unions or community-based organizations, would also improve accountability of implementing agencies and act as a check against corruption and patronage. In this regard, the fact that the Khushal Pakistan program incorporates active community participation in program selection is a positive feature. And as noted by the Pakistani government, since the ongoing devolution program in the country can help strengthen local governments and create accountability, the success of the Khushal Pakistan will be linked to that of this broad devolution exercise.

## *Microfinance*

5.25 As noted in Chapter 4 of this report, market failures in rural financial markets contribute greatly to the vulnerability of the poor by depriving them of access to credit and insurance. By lending to groups, which leverages the social information that the poor have about each other, microfinance schemes are often able to circumvent the informational problems that are responsible for the failure of the formal financial sector in rural areas, and are consequently able to achieve high repayment rates. Since credit and insurance are closely related in the context of the rural poor, microcredit also plays the important role of insurance against income shocks. A review of such microfinance programs in Pakistan upholds observations about the potential of this model but also suggests that many additional improvement and changes are warranted, including expanding coverage, deepening alliances with formal market institutions such as banks, and regularizing public support for some programs. In addition, there appears to be considerable scope for using microfinance institutions to channel additional services to local communities.

5.26 In Pakistan, the main impetus to microfinance has come from the NGOs, primarily rural support programs (RSPs). RSPs are an experiment with models of participatory development based on institution building, which incorporates microfinance. The overall strategy, pioneered by the Aga Khan Rural Support Program (AKRSP), seeks to establish self-help organizations and cooperatives whose leaders are to be trained continuously and redeployed for the benefit of village communities. In recent years, provincial as well as national RSPs, created to follow the pioneering approach of the AKRSP, have expanded their outreach significantly. At the end of 1999, 62 districts in Pakistan had been covered by various RSPs. The program has mobilized savings of Rs. 697 million and disbursed credit in the amount of Rs. 3 billion. In addition to the role played by RSPs, microfinance has spread rapidly through the efforts of numerous other non-governmental entities, both large and small.

5.27 These efforts share a number of positive characteristics. Microfinance service providers in Pakistan generally work with and through community-based groups that they have helped to form. They build the leadership, management and credit capacity of these groups before they commence lending. Concomitantly, almost all microfinance providers are engaged in the delivery of other services, most commonly social infrastructure, welfare services and improved natural resource management. The relative success of microcredit schemes launched by the RSPs is largely because their lending policies have been conservative.

5.28 In spite of its rapid expansion, significant challenges confront microfinance in Pakistan. It is still unable to extend coverage to the vast majority of the poor, and efforts like those of the RSPs tend to be concentrated in the northern areas. The rate of penetration is low in rural Sindh and Balochistan. Most microfinance programs are also unable to attain sustainability by charging sufficiently high interest rates and finding investment opportunities that yield returns higher than the cost of borrowed funds. The microfinance system thus needs to establish a sustainable framework in order to reach much larger numbers in future, rather than remain dependent on donor or government funds.

5.29 In order to promote efficiency, there may accordingly be a need to foster competition in the microfinance market both spatially and in terms of performance and customer choice. Non-traditional approaches, like partnerships with commercial banks, may also work to generate funds. There are some encouraging indications of such collaborations. Recently, the National Rural Support Program (NRSP) and the Sarhad Rural Support Program (SRSP) successfully negotiated with two commercial banks for credit lines for their lending operations.<sup>11</sup>

5.30 In view of the heightened demand for microcredit in poor communities, the Pakistani government and donors for their part have realized the need for ensuring the supply of sufficient funds on a

sustainable and institutionalized basis. In order to guard against the possibility of deployment of these funds as vehicles for patronage and corruption, two major on-lending institutions have been set up to channel the funds, detached from the governmental bureaucracy by the intermediation of NGOs and the private sector. The Poverty Alleviation Fund (PPAF) has opted to disburse wholesale credit through selected NGOs, and a newly created Microcredit Bank has also institutionalized retailing credit to individual borrowers, through with the cooperation of nationalized commercial banks and local organizations (Box 5.3).<sup>12</sup>

#### **Box 5.3: Recent Initiatives in Financing Microcredit Programs**

The Poverty Alleviation Fund (PPAF) was launched in 1999 by the Government of Pakistan with a view to create an efficient mechanism for publicly financing community development programs and NGO projects. Technical assistance and initial funding to this end was provided by the World Bank. The Board of Directors of this autonomous body has 13 members, of whom 9 are civil society representatives. The autonomy of the PPAF and its emphasis on partnerships is intended to ensure that funds for poverty alleviation reach the targeted beneficiaries. The program will provide credit to the poor, small-scale community infrastructure projects, capacity building, institutional strengthening and training. To qualify for funding, an NGO has to have a track record of at least two years. To track carefully the kind of NGO programs that are funded by the PPAF and their impact, future evaluations of the PPAF are imperative.

The Microcredit or Khushali Bank was launched on August 11, 2000, in Dera Ghazi Khan, a poor district of Punjab. Its founding capital had been provided by a number of public and private banks, including foreign institutions. By the end of its 5<sup>th</sup> year, the bank is expected to cover all districts with a client base of 600,000 and a loan portfolio of Rs. 7.6 billion. The Bank is supposed to lend small amounts ranging from Rs 2000 to 15000, though these may in some cases be higher, on need basis. While the loans are at market-based rates and the bank plans to mobilize deposits from the public, the structure of the bank is non-profit oriented, which minimizes its intermediation costs. The processing of loans is further strengthened through the involvement of community-based organizations (CBOs) in lieu of the traditional collateral requirements of the commercial banks. The Bank management envisages achieving financial sufficiency within three years and full financial efficiency within five to seven years.

5.31 Notably, there are a few broad concerns regarding the operation of these institutions. With regards to the PPAF, an important question is how its benefits are being distributed across the country and among different kinds of community organizations. It can be argued that the community-based efforts that the PPAF would usually fund, are more likely to prevail in areas where a certain level of community organization already exists, perhaps due to a history of engagement with ventures such as RSPs. If indeed that is true, there is a risk that communities that are deficient in social capital and which are also likely to be particularly poorly off remain untouched. In order to address such concerns, the PPAF should focus efforts on identifying programs in “difficult” areas, where the existing social and political structures act as obstacles to efforts by communities to organize for their common good.

5.32 In order for the Khushali Bank to realize its potential impact, it will be imperative to avoid the pitfalls that have hamstrung rural credit provision in the past. Past failures have occurred mainly due to information problems, connected with the inability to monitor borrower performance. This in turn has necessitated collateral, which the poor do not possess. The challenge for Khushali Bank will be to retain the characteristics of microfinance that circumvent these information problems, while conducting operations on a scale much larger than attempted by NGOs. For sustainability, it will be imperative to achieve high repayment rates, while charging interest rates that cover the cost of lending.

5.33 For the long-term sustainability of microcredit, and the creation of conditions conducive to scaling up these programs, links between microfinance institutions and formal markets must be strengthened. In keeping with this objective, the State Bank of Pakistan (SBP) has envisaged licensing three categories of microcredit institutions at national, provincial and district levels, as public or private limited companies.<sup>13</sup> This will enable them to raise capital and generally exploit opportunities in the formal sector. These institutions will however not be subject to the same degree of surveillance by the SBP as other banking institutions, allowing them the needed flexibility in operations. In this context, it

will be necessary to develop a regulatory framework that addresses the unique aspects of such enterprises, while promoting transparency and financial accountability.

5.34 Recent experiences in developing countries have also shown that the community-based characteristics of microcredit are applicable to the provision of an entire range of financial services to the poor, including saving services and insurance schemes that provide valuable risk management benefits. Examples of such initiatives can be found, among others, in the efforts of Grameen Kalyan in Bangladesh, which provides medical and life insurance to a sizeable number of the rural poor in Bangladesh. Such efforts have not been undertaken in Pakistan, and there is a case for initiating some pilot efforts that could test the viability of such programs. Public policy can support these efforts by providing technical and financial support in the start-up phase, and in the long term by creating an enabling legal and regulatory framework for such institutions.

#### *Urban Housing and Infrastructure Programs*

5.35 The programs described so far attempt to address different dimensions of vulnerability, primarily as a function of income. Because lack of secure and adequate urban housing is an important determinant of urban poverty and vulnerability in Pakistan, programs to improve access to this vital asset - initiated by the government and the civil society alike - are also assessed in the broad-based context of social protection strategies in the country. While there have been some less successful attempts to address this problem, trial projects have been promising. In aggregate, these experiences point to the need for greater community participation in leveraging limited resources, and for providing complementary income support and access to credit in the contexts of securing and improving urban living conditions.

5.36 One of the more neglected yet important correlates of urban poverty and vulnerability is the lack of adequate housing, combined with the lack of basic facilities like access to electricity, safe drinking water, and sanitation. Historically, most of the projects undertaken by the Pakistani government to meet the housing needs of low income groups have been such that either the end product was not tailored to the needs of the poor, or priced so high as to be unaffordable.<sup>14</sup> The result of the failures of government housing schemes, coupled with rapid urbanization, has been that an estimated 40 to 60 percent of the urban population currently lives in *katchi abadis*, or non-regularized subdivisions on agricultural land.<sup>15</sup>

5.37 The living conditions in *katchi abadis* are associated with a high degree of risk for the inhabitants, arising from lack of security of tenure, and lack of basic amenities, like safe water and sanitation, which increases health risks. Programs to address the urban housing crisis should therefore have a significant impact on vulnerability. Responding to this need, the government in 1978 started the Katchi Abadi Improvement and Regularization Program (KAIRP). It envisaged infrastructure development and the granting of tenure for the residents of *katchi abadis*, against repayment of land and development charges. However, it has failed to achieve its targets for a number of reasons; these include the high costs of upgrading squatter settlements, lack of community participation, and lack of capacity and capability in the implementing agencies. In addition, there are no avenues for credit available to low-income groups and the poor for housing.

5.38 In contrast, less ambitious programs like the Orangi Pilot Project (OPP) that have sought to organize communities to help solve problems in securing infrastructure facilities like sanitation, have met with more success.<sup>16</sup> Innovative programs like OPP share a few common features that suggest guidelines for future initiatives, whether initiated by the government or NGOs. First, they have accepted the situation on the ground with respect to the existence of these settlements and have refrained from imposing artificially high standards of construction and sanitation, which are well beyond the means of both the state and the households. Second, they have relied on the community's own involvement in

finding the solutions to their housing problems, for instance, in accessing the services of the line departments. They have also encouraged networking with technical experts.

### **Human Development – Education and Health**

5.39 Education outcomes in Pakistan improved very little during the 1990s, especially in rural areas. Moreover, while key health indicators like infant and child mortality have shown some improvement, they remain poor in absolute terms and still lag well behind what is found in most countries at a comparable stage of economic development. In addition there are wide gaps in educational attainment between males and females and between rural and urban areas. Available health indicators document a similarly substantial gap between rural and urban areas. A shortage of facilities, a crisis in implementation, and low demand for some services are the three most important reasons for these failures.

5.40 As documented in Chapter 3, the availability and quality of facilities is critical to improving health and education outcomes. The evidence provides a strong basis for concluding that the scarcity of adequate facilities is a significant constraint on progress in health and education. The converse is more encouraging: more investments in facilities, despite potential demand-side problems, should have a strong impact on health and education outcomes if these investments are accompanied by major steps to correct the institutional failures and obstacles to delivery that have hampered access to quality services in the past.

5.41 Institutional obstacles were a key reason for the failure of Pakistan's Social Action Program, which to date represents the most concerted effort by its government and donors to remedy the country's social gap. It is also instrumental in the limited progress in preventive health care.<sup>17</sup> According to PIHS (1996-97), only about half of the children in the country were immunized in 1996-97, implying that the national health system failed to reach over 9 million out of 19 million children of age 5 and under. Another serious indicator, highlighted in Chapter 3, is the prevalence of chronic malnutrition among very high portions of children in sampled districts. As detailed below, these failures points to the detrimental consequences of inadequate government support for social policy and the appropriation of expenditures by local patronage politics.

5.42 Pakistan's recent devolution and governance reforms are encouraging, yet as noted in Chapter 3, their success will be contingent on ensuring true competition in local elections. In addition, some federal intervention will probably be necessary in addressing intra-regional gaps. Beyond discussing relevant supply-side problems, this section also elaborates ways of tackling demand side problems born of social and other barriers to health and educational attainment. An indication of the former is that while family planning programs have been successful in almost universalizing knowledge of contraceptives, only about 20% of the women in childbearing age used some form of contraception in 1998-99. In the context of education, where low demand for girls' education appears to be a problem, the potential utility of incentive subsidies to households is considered, along with the potential for harnessing further private sector involvement in educational provision. To assess the performance of such reforms, there is a need for considerably better monitoring and collection of information on educational and health outcomes in Pakistan.

#### *The Social Action Program*

5.43 The experience of the Social Action Program (SAP) underlines the difficulties of a facilities-focused approach that neither addresses severe institutional nor demand-side obstacles to social progress. The SAP was launched in 1992/93 with the objective of furthering social development in Pakistan and has to date disbursed Rs.145 billion (See Box 5.4).<sup>18</sup>

#### Box 5.4: The Social Action Program in Pakistan

One of the main reasons for Pakistan's lackluster record in social development was the low level of public expenditure in this area. The SAP aimed at increasing public spending (especially non-salary operational expenditures), and improving the institutional and policy framework necessary to deliver services more effectively. Its failure to meet this expenditure commitment has been a major reason for its failure to date.

The SAP was been implemented in two Project phases. The first phase, SAPP-1, covered the period from 1993-94 to 1996-97. The second phase, SAPP-II, began in 1997-98 with a planned duration of five years ending in the year 2001-02.<sup>1</sup> The SAP agreements have required the government to raise the proportion of GDP spent on basic social services from 1.6 per cent in 1993-94, to 2.19 per cent by 2001-02. This has now been revised down to 1.95 percent in view of the severity of current macroeconomic adjustment problems. The Social Action Program ended in June, 2002.

However, in 1998-99, the Government's contribution to SAP reached a low of 1.46 percent, compared to the targeted 1.8 percent. Moreover, the gap between the Government's targeted and actual expenditure on SAP as a percentage of GDP has been increasing since its inception. A related concern is whether the rising recurring expenditures arising from net increments to sectoral capital stock as a result of successful SAP investments will be sustainable, given currently high budget deficits and low revenue mobilization potential, especially on the part of the provincial governments who are primarily responsible for the implementation of the program.

5.44 The program explicitly aimed at increasing the physical availability of services and improving their quality in four distinct target areas – elementary education, basic health care, family planning, and rural water supply and sanitation. It was targeted especially at the poor and women. To this end, the SAP emphasized building schools (especially for girls), basic health and family planning facilities in rural areas, engaging support staff from communities, and adopting a participatory, team-based management style at the facility-level.

5.45 Since the objectives of the SAP overlap significantly with those emphasized in this report, it is important to ask why the SAP, as the evidence suggests, fell short of its objectives. Measured in quantitative terms, SAP progress in the education and health sectors has been disappointing. Some improvements have occurred in health indicators and access to related infrastructure over the years of SAP-I.<sup>19</sup> The program has also had successes in areas like immunization and the availability of Lady Health Workers. However, the gains have been marginal, and especially so in education, which has been the major area of focus. In fact it appears that SAP-I has succeeded more in terms of accelerating construction of facilities than in increasing the supply of educational materials, medicines and the on-the-ground delivery of services. Consequently, the impact on enrollments and other measures of school attainment have been limited or non-existent, as evident from the trends described in Chapter 3.

5.46 One reason for these disappointing outcomes is the continued politicization of the distribution of benefits under SAP. Implementation of the program was often used as a vehicle for patronage, at the expense of community participation and often in direct conflict with the planned goals.<sup>20</sup> For example, while many local landowners were willing to provide land for a school in their village, the motivation in most cases was that they could then hire teachers for the school as an act of patronage or, in some reported cases, to solicit bribes from teachers. This resulted in the phenomenon of "ghost schools" widely reported in some areas, and other forms of less extreme patronage and "elite capture".<sup>21</sup> The politicization of SAP and the extent of patronage in the program probably had serious exclusionary effects on those communities that did not belong to the right political faction, giving rise to stark inter- and intra-district disparities.

5.47 Several sets of reforms are discussed here that are intended to dramatically improve the performance of future programs to promote human development. These include ensuring that devolution

succeeds in mitigating political problems that have undermined SAP; the explicit and increased use of private sector participation; and explicit attention to problems on the demand-side, including, importantly, the reluctance of some population groups to take advantage of service enhancements.

### *Devolution and Service Delivery*

5.48 Future reform efforts must directly address the incentives and institutional arrangements that allowed and abetted the pattern of poor implementation that crippled SAP-1. Pakistan's new devolution plan, finalized in August 2000, is the most important current effort to do this (Box 5.5).

5.49 Devolution may lead to increased participation of communities in decision-making and greater accountability of government officials for better service delivery outcomes. However, as discussed in Chapter 3, whether devolution reaps these results will also depend on the extent to which it solves fundamental governance problems that have bedeviled earlier efforts to improve service delivery. Given the nature of political competition in Pakistan and the widely observed phenomenon that "traditional elites" seem to have won many of the local government elected offices, there are many reasons to temper one's optimism.

#### **Box 5.5: Decentralization and Devolution in Pakistan**

Pakistan's new devolution plan, finalized in August 2000, seeks to reform its over-centralized government in order to improve decision-making, accountability and service delivery.

The devolution plan has four major objectives: 1) "to empower the people at the grass roots level; 2) to subordinate district administrative functionaries to elected representatives, 3) to give financial autonomy to local government; 4) and to ensure "speedy justice at the doorsteps of the people." Special reference is made to those poor harassed and intimidated by corrupt police and local administrators. Accordingly, the plan will provide for monitoring of the police by union members, changes in judicial structure, police reforms, and separation of the judicial and administrative functions of local authorities.

The plan envisages the creation of full-fledged district governments with legislative and financial powers, serving below the federal and provincial levels. This structure has three-tiers, with direct popular elections to the first level: the Union Councils (UCs). The other two: the Tehsil Councils (TCs) and the Zila (district) Councils (ZCs) were indirectly elected by the UC members, acting as an electoral college. Co-elected Nazims and Naib Nazims head the councils at each level, and serve as members in the superceding electoral colleges. A salient feature of the election to all local government was that political parties were not allowed to promote their candidates, who instead had to run on individual ballots. A system of separate electorates for minorities endured, and one third of seats will be reserved for women. There will be a new system of fiscal transfers to the Zila districts through provincial finance commissions. Each district will be allocated funds on the basis of its size and its social and development need. Local budget planning will be done by the Union Councils and monitoring mechanisms will reportedly be built into the system to guard against corruption.

The plan is being implemented in several phases, with much work remaining. The question of how to mobilize local resources remains unresolved. Federal and Provincial governments are reluctant to share existing resources, particularly given the strained fiscal situation. At present, local government receives funds from the provinces, which themselves lack the funds for the delivery of the various services, especially in the social sector. Other key elements of the plan - the fiscal framework, administrative arrangements, civil service structures and management, and effective accountability and participation mechanisms - have also yet to be fully implemented.

The devolution plan was finalized after considerable consultations with stakeholders, including external donors. The inclusion of several established NGO representatives active in both the central and provincial cabinets has added credibility to the undertaking. Notwithstanding the continued influence of local elites, there is reportedly some evidence that new voices have appeared at the local level, contesting elite capture of local government and anti-poverty programs. These garner support mainly among those elected on the reserved seats for women and from peasants, workers, and NGO groups. It is not only Pakistan's experience, however, that the building of new institutions is rarely enough to make them work as intended.

*Source:* Interim PRSP (2001); Naseem (2001): "Government and NGO Programs in the Alleviation of Poverty in Pakistan: A Political Economy Survey"

5.50 As also noted in Chapter 3, optimism is more justified to the extent that newly elected local officials confront greater political costs in undermining education and health provision in order to generate patronage opportunities, relative to provincial and national government officials who have controlled these sectors in the past. This is likely to be true, since those who suffer from such diversion will find it easier to punish local officials when they transfer resources from some district inhabitants to others than when distant politicians in Islamabad or Lahore transferred resources entirely away from their district. Optimism is further justified if, under the structure envisaged by devolution, there are more checks operating on officials who try to provide patronage. Until now, the highest district officials have been able to make decisions in a strictly hierarchical fashion. Under devolution, however, the District Nazims could potentially be checked by the district councils, provided that the councils and Nazims are independent of each other.

5.51 Of course, a necessary pre-condition for positive changes is that elections at the local level be competitive. If one or two families, *biraderis* (kinship groups), or individuals dominate electoral competition in most Union Councils throughout a District, then one would expect little change in public good provision. A preliminary analysis of the elections does suggest that these were generally competitive, though the impact of devolution, especially on measurable indicators of education and health, will only become apparent over a long time horizon.

5.52 However, two important issues regarding service delivery are not solved by devolution. First, there are severe distributional inequities in the provision of health and education, most of which extend across districts. In addition, there are inequities across the rural-urban divide. These problems therefore require attention at higher levels of government. It is also important that the government focus on the issue of equity and enact measures aimed at reducing problems of differential access for disadvantaged groups, which as discussed in Chapter 3, may be relevant particularly in the case of access to education.

5.53 Second, there are significant demand side problems – difficulties in encouraging families to take full advantage of the services that are made available in the health and education sectors. This appears to be especially true in the context of parental resistance to the education of their children, and in particular to girls' education in rural areas. Addressing such demand-side issues may require interventions that seek to overcome social barriers to girls' education through incentives, monetary and otherwise, to parents. Such interventions are likely to be beyond the resource capacity of local governments, and are in any case likely to be politically contentious in districts where this is a problem. They will therefore require significant resources and the continued, even increased, involvement of higher-level governments.

5.54 The government's medium term health strategy rightly takes such concerns into account. It is concentrating on prevention and control programs, especially in the area of reproductive health, child health, nutrient deficiencies and communicable and infectious diseases, where demand-side problems are most acute. Programs include adoption of strategies against TB and malaria, measures for preventing the spread of Hepatitis B, HIV, and AIDS through immunization and public health campaigns. Distributional concerns are also paramount, since the strategy promotes targeted interventions that focus on disadvantaged sections of society, especially in rural areas, through programs like Lady Health Workers Program and Women Health Project.

5.55 A community based focus for health policy is also in line with the observation made in Chapter 3, that community-specific characteristics, such as wealth and possibly the presence of quality health facilities, strongly determine health outcomes in Pakistani children. This is particularly the case for the noted chronic deficiencies in child anthropometrics, e.g., height and weight, in rural communities – a symptom of malnutrition and other health problems. There is accordingly a clear need to target health interventions at poorer communities.

5.56 Specific ways to solve the demand-side problem in the delivery of social services are still under discussion. One intervention that has met with success is outright subsidies to households, such as the Bangladesh Food-for-Education and Female Education Scholarship programs, which link food transfers and scholarships for poor households to primary school enrollment of their children, particularly girls (Box 5.6).

5.57 In Pakistan, Food for Schoolgirls, run by the World Food Program, is one program that addresses the problem of demand-side incentives. Implemented in selected government girls' primary schools in rural Balochistan and NWFP, it provides an inducement in the form of a tin of edible oil to each student if she attends school for 20 days in a month. The project is still not at a stage where it can have a tangible impact on keeping girls in school, and dropout rates are still high. It does seem to have increased enrollment rates, and with greater community awareness, the WFP feels that enrollments can eventually be sustained without the oil incentive. Going by experiences like these, there is a strong case for extending the role of demand-side incentive programs for education in Pakistan.

**Box 5.6: Food for Education and Female Education Scholarship Programs**

In Bangladesh's Food-for-Education (FFE) program, households with a child in primary school receive a certain amount of wheat or rice per month, provided the children attend at least 85 percent of their classes and the family sends all children of primary school age to school. The program has achieved wide coverage – an estimated 2.1 million households, covering 1243 unions out of approximately 4500 in the country. Another example of a program that provides demand-side subsidies is Bangladesh's Female Education Scholarship Program. According to this program, female students are given a stipend as they progress through secondary grades 6 to 10. The stipend provides for full tuition and examination fees at all grades; it also covers an increasing proportion of the cost of textbooks, school supplies, uniforms, shoes, transport and kerosene (for lamps) as students advance to grade 10, reflecting the higher direct and opportunity costs of enrollment in the upper grades. Evaluations showed that participating schools witnessed a sharp increase in female enrollment, including a reduction in dropouts, though there was no impact on repetition rates.

*Source:* Burnett (2002). "Pakistan: Working with the Private Sector in Primary and Middle School Education", World Bank

5.58 An additional element in future strategies to increase access to health and education should be to recognize the already important role of the private sector. As noted in Chapter 3, there has been considerable growth in private schooling since the denationalization of 1979, particularly in the rural areas. Moreover, preliminary evidence suggests that these schools provide better quality education than government facilities, at a lower total cost per student, and no longer cater only to an urban elite. There is some evidence, as noted in Chapter 3, that private schools have a positive impact on educational outcomes, particularly in regards to encouraging female enrollments. The government of Pakistan's Education Sector Reform (ESR) program recognizes the opportunities embodied in the growth of private education, and rightly places a high priority on strengthening public-private partnerships in the delivery of educational services. The ESR proposes a number of incentives for private schools, including fiscal incentives such as concessional rates on land and utilities, increased endowments for the Education Foundations, and the outsourcing of government schools to the private sector.

5.59 These are particularly urgent in light of the constraints faced by the government to quickly extend universal access, even in urban areas. Future reforms might therefore include providing choice to parents in the form of vouchers for education at private schools, or as direct subsidies to private schools. These subsidies would be especially pertinent in urban areas where private schools are more common, and in communities where public school facilities are non-existent or inadequate.

5.60 The Quetta Urban Fellowship Program is one interesting example of the use of such subsidies. There, private schools controlled by communities in poor neighborhoods of Quetta were encouraged to establish new facilities for girls through subsidies paid directly to the schools. While boys could also enroll in the fellowship schools, they could not make up more than half the total enrollment, and schools received no subsidy for enrolling boys.<sup>22</sup> An evaluation of the program reveals that it had a positive impact on female enrollments, increasing girls' enrollment in the target neighborhoods by around 33 percent. Interestingly, boys' enrollment rose as well, partly because boys were allowed to attend the new schools, and partly because parents would not send their girls to school without also educating their boys.<sup>23</sup>

5.61 Notably subsidies to private schools or vouchers to parents entail complicated choices. The arguments in favor of subsidies are that private schools are more efficient and that public-private competition tends to improve quality. These need to be weighed against counter-arguments that contend that scarce public resources would be better spent in improving the public school system, which has more universal reach. In addition, as discussed in Chapter 3, the non-standardization of private educational provision makes it difficult for parents to distinguish between low and high quality schools, which can lead to inefficient outcomes if poor quality institutions can get away with charging high prices. A proper regulatory framework is crucial to address these potential informational problems, with the important caveat that this framework not be so burdensome that it forces private schools to raise their fees in response to higher costs. For example, a national assessment mechanism can help in determining the relationship between price and school quality, and greatly facilitate parental choice. The national assessment currently being implemented by the education ministry represents a beginning in the direction of making such information publicly available.

5.62 Private-public sector partnerships can also be advanced in health. For example, the government's Health Policy calls for a strengthening of public-private sector partnerships. These include requirements that every medical college in the public and private sector adopt at least one district hospital or primary health facility in addition to the teaching hospital affiliated to it. There are also regulatory reforms directed at the private sector, specifically with regards to the accreditation of private hospitals/clinics, and at improvements in the government's capacity for quality control of drugs.

5.63 Fundamentally, a comprehensive health policy framework is conditional on the availability of adequate health data, and as discussed earlier, such data is seriously lacking for Pakistan. Specifically, there has been no comprehensive national study of private health facilities in Pakistan, which poses a critical impediment to further efforts that would seek to promote public-private health partnerships. In regards to data collection, a broader priority for the government should be the development of a disease monitoring and information gathering system that would regularly gather information on relevant health indicators, and impose rigorous standards of record maintenance in health facilities.

### **Coordinated Strategies for Addressing Rural Poverty**

5.64 Two thirds of Pakistan's poor live in rural areas, and given both the weight and specific determinants of rural poverty, it is particularly important to devise a coordinated strategy for addressing rural poverty in the country. As discussed in Chapter 4, a central concern is the fact that agricultural productivity is in absolute terms very low in Pakistan and needs improvement. Accordingly, this report surveys the structural constraints on farm productivity, e.g., the limitations on access to productive resources; principally, land, irrigation, soil fertility, and credit. A related and important concern is that growth in agriculture apparently failed to mitigate rural poverty in the 1990s compared to the previous decade. While a rigorous and comprehensive analysis of this puzzle was not possible using the data available to this report, such work is being undertaken in the context of ongoing Bank work.

5.65 In regards to constraints on productivity in the farm sector, there is first a need to improve household access to assets, in particular land. Historically poor outcomes of land and tenancy reforms, examined in light of some innovative new initiatives, point to the importance of improving not only the distribution of land but also complementary access to agrarian inputs and credits. Improving credit allocation generally requires moving away from supply driven mechanisms, and improving and broadening micro-credit practices noted earlier. Programs that promote investments in the non-farm sector should be further encouraged since diversification out of agriculture has been shown to mitigate rural vulnerability and poverty. Particularly in light of Pakistan's growing drought problem, which has caused water resource deterioration the chapter highlights programs that improve access to rural infrastructure, focusing on efficiency in irrigation. Increased public investment is warranted here, but some successes to date stress the importance of local governance reforms, particularly in the form of more community participation in local land and resource management. As the title of this section suggests, these and other measures should be designed and implemented in a coordinated fashion, due to considerable interrelationships among the various constraints addressed.

5.66 Before elaborating on these strategies, it is important to note that an overarching precondition for their success in promoting growth in agricultural productivity is that they be undertaken in the context of wider macroeconomic and fiscal policies that are conducive to such growth. Crucially, this entails avoiding price distortions that skew incentives for the agricultural sector, about which there are still some outstanding concerns. It is encouraging, however, that policy initiatives announced by the government do address some of these. The I-PRSP documents a few interventions for the agrarian sector which can be broadly summarized as follows: improving incentive structures for farmers (price reforms), upgrading technology and marketing (better cropping patterns, corporate financing), improvement in access to land by distributing government land to poor households, and improving efficiency in use of water (irrigation reforms).

#### *Improving access to assets*

5.67 Rural assets such as land continue to be of critical importance, in view of the evidence in Chapters 2 and 4 about the negative impacts of the observed highly unequal distribution of land and other key assets, on investment and productivity, in addition to the vulnerability issues also discussed. The sharp inequities that prevail in ownership of land, and the friction in the markets to lease land, militate for land reform. However, such reforms are politically problematic to implement. To date, experience in Pakistan has been mixed at best. Previous major attempts at land reform, undertaken during the regimes of Ayub Khan (1962) and Zulfikar Ali Bhutto (1972), have not succeeded in redistribution, particularly to tenants and landless, and also appear to have been ineffective in ensuring security of tenure.

5.68 Redistribution should be accompanied by tenancy reform, in order to prevent eviction of tenants by landlords in the anticipation of land reform. The evidence on tenancy reform seems to suggest that it often remained confined to paper transactions with little real significance, and, while landowners may not have directly evicted their tenants, they may have made the situation unbearable for tenants to continue surviving on their land. This is especially so in Punjab, where the relative success of reforms has also had the unintended and unfortunate consequence of creating an expectation among Punjabi landlords of more reform in the future, resulting in a disproportionate rate of tenant evictions in this province, compared for instance to Sindh.

5.69 An alternative strategy to provide better access to land could involve market-based land reform. However, the diagnostics in Chapter 4 suggest that the potential for such reform is very limited in an environment where both land sales markets and land leasing markets function poorly. As Chapter 4 points out, a possible precondition for serious land reform might be to improve the market environment for purchase and lease of land, notably by improving the legal system for enforcing foreclosures on the

one hand and access to credit on the other. Landless farmers who cannot provide collateral are particularly constrained in obtaining credit for purchasing or leasing land. As illustrated in Box 5.7, a possible intervention to remedy this may involve fostering innovative linkages between two government interventions that already exist, in the areas of micro-finance and land allocation.

**Box 5.7: Innovative Experiments in Micro-finance and Land Allocation**

NGOs working for the rural poor have often intermediated in credit markets through micro-finance programs. There are organizations of the landless poor, however, that have also begun experimenting with intermediation in the land leasing market. Case studies of two such NGOs, in the Sanghar and Khairpur districts of Sindh, have revealed innovative models of intermediation. These organizations rent land on the lease market and then sub-let it to individual members on the basis of deferred rental payments. The organizations use their social collateral to raise capital from larger NGOs, thereby relieving their members' liquidity constraint. They also allowed income smoothing for their members over 4 to 6 crop cycles, thereby alleviating vulnerability to risk. Both of the experiments resulted in sustained improvements in the asset positions of their participants.

Surveys in the field areas of rural support programs (RSPs) in two districts of southern Punjab (Multan and Dera Ghazi Khan) reveal informal attempts at similar interventions by RSP supported community organizations. The design of the micro-finance programs of the RSPs, however, is not well suited to sustained intermediation in the land leasing market.

The NGO experiments in the leasing market are significant because they represent attempts at tackling the problem of land inequality in an innovative manner by working through existing markets. Their economic role in the leasing market was analogous to the now familiar role of intermediation that community organizations play with respect to micro-finance. Encouragingly, there is already a wide network of RSPs in Pakistan, which might be able to expand the scope of such innovative experiments, and when appropriate, to take them to scale.

*Source:* Gazdar, Khan and Khan (2002). "Land Tenure, Rural Livelihoods and Institutional Innovation"

*Improving access to credit*

5.70 As Chapter 4 concludes, access to institutional credit is severely restricted in rural Pakistan, with the bulk of the cultivator households, in particular the landless, being rationed out of the market. Improved access to assets (collateral) should have a useful impact on access to credit, in particular institutional credit. However, the import of credit access extends beyond collateral problems in two ways: to expand the ability of poor farmers to undertake productive investment, and to enable poor households to smooth their consumption and mitigate risk. To smooth consumption has been discussed in the context of social protection earlier in this chapter. To undertake productive investment underscores the crucial link between agricultural productivity and rural poverty on the one hand, and access to credit in rural areas on the other.

5.71 By and large, credit programs in rural Pakistan have not only been unable to address the credit market needs of the rural poor but have also been difficult to sustain financially. Reforming the financial sector will thus be imperative, though not easy in an environment where asset inequality is severe. One problem is the supply driven nature of existing programs to expand credit in rural areas. In this regard, Pakistan's experience mirrors that of many other countries. These demonstrate that creating a viable rural credit delivery mechanism will require (i) deepening of financial intermediation through mobilization of savings in rural areas, (ii) moving away from a supply driven delivery mechanism to a market based system which creates an enabling environment for private sector participation, (iii) utilizing innovative and alternative savings mobilization and credit delivery instruments for small farmers and non-farm producers (such as microcredit) who tend to remain outside the network of formal financial institutions.

5.72 As discussed earlier, access to institutional credit in rural areas, particularly for the poor, is severely constrained by market failures due to information problems that arise from the isolation of the poor from financial markets. While microcredit provides a viable alternative to formal markets, it should

not be seen as a panacea for all credit problems. For instance, microcredit has been found to play a more successful role in smoothing consumption and helping with small investments in household enterprises than in productive investments of the kind usually necessary for agriculture. There is thus a need to understand the strengths and limitations of microcredit institutions in rural areas.

5.73 Other solutions to lack of access to credit for farm investments must also be examined, such as the reasons why the existing village banking network has proved highly inadequate in satisfying credit needs, and possible reforms that can address weaknesses in this sector. A decline in the number of banks and a fall in the share of commercial lending in total agriculture credit in recent times all suggest that financial markets in rural areas have thinned, instead of deepening, during the 1990s.

5.74 A long-term strategy in deepening the financial market would have to focus on institutional reforms to address information problems in rural credit markets that are primarily responsible for market failures. The focus should also be on exploring ways to create an enabling environment for private sector participation in the rural financial sector. Doing so will involve providing the right incentives (avoiding subsidies and bailouts that distort incentives), and creating institutions that promote transparency through oversight and prudential regulations. Overall, the further specification of rural financial reforms is subject to a complex set of factors, which require rigorous analytical work using recent data, beyond what has been undertaken to date.

#### *Improving opportunities in the non-agricultural sector*

5.75 As noted in Chapter 4, the non-agricultural sector is a significant source of income for both rich and poor households and constitutes an important de facto stabilizing influence on the latter's incomes. Indeed, wage labor in the non-agricultural sector, particularly in unskilled occupations, are a major source of income and employment for the poorest quintile of the rural population. These findings suggest that facilitating investment and productivity in non-farm enterprises that result in raising wages and profits would have an impact on large sections of the rural poor. Improving the investment climate and providing better access to inputs and credit would be necessary, especially for the small household enterprises that typically face binding credit constraints.

5.76 It is also important to bear in mind that growth and productivity of the rural non-agricultural sector are inexorably linked with those of the farm sector. In order to exploit these linkages, rural policy must seek to integrate strategies to address issues in the agricultural and non-agricultural sectors. Notably, a strategy that takes into account the range of complex issues must be informed by more analysis to better understand the constraints to productivity and growth of the non-agricultural sector.

#### *Improving access to infrastructure*

5.77 Since opportunities tend to be higher for communities that are better connected to markets, there is a need to extend access to a broad range of facilities in the agricultural sector, including electricity, roads, and other forms of communication. In the context of access to rural infrastructure, of critical importance is the availability of adequate water for irrigation and domestic use, which constitutes a key constraint in Pakistan's rural economy. Due to arid or semi-arid climate and inadequate water resources, cultivation in Pakistan is overwhelmingly dependent on irrigation. The problem of water shortage has acquired even more importance in the wake of acute droughts in 2000 and 2001. Although many parts of Sindh and Balochistan had been experiencing drought-like conditions from before 1998, the situation worsened during these years, engulfing the entire country. The continuing dry spell has affected agricultural output, causing value added in the agricultural sector to register negative growth (at -2.5%) as against growth of 6.1% during the previous year.

5.78 Since increase in agricultural productivity requires increased water availability, an expansion in production depends on improving the efficiency of the existing irrigation system. The recently formulated government water management program has focused on creating additional storage capacity through projects like Gomalzam and Meerani dams, Raineer, Thar and Kachi canals and the lining of watercourses. These initiatives are expected to provide additional storage capacity of 4.5 million-acre-feet of water. While initiatives to expand capacity will help address the problem, for various reasons, prospects for further expansion in irrigated areas through new investments in storage capacity, expansion of perennial irrigation, and ground water exploitation appear to be limited. In light of this, improvement in the efficient use of currently available water use seem to be the most viable and sustainable option for increasing productivity of irrigated agriculture.

5.79 According to some estimates, around 25 million-acre-feet of water are lost every year in the system due to low water management efficiency. Indeed the evidence in Chapter 4 shows that there is considerable room to improve the efficiency of the irrigation infrastructure. Delivery efficiency has been deteriorating over time because of poor incentives for the irrigation department to invest in maintenance. In addition, there is considerable wasteful use of canal water because of the flat rate charges. Finally, rent-seeking behavior by large landowners and irrigation officials has led to misappropriation of canal water, which has in turn increased the existing distributional inequities. In light of the evidence in Chapter 4 on the productivity increases that can be attained by increasing canal water availability, removing these existing inefficiencies in canal water infrastructure could be an effective strategy to increase agricultural productivity.

5.80 Efficient management of tubewell and canal water irrigation is also important because it can affect salinity and water logging, which have a significant negative impact on productivity. The strategy to reverse these problems requires both public and private investment. An integrated drainage system with proper lining of the canal is important in reducing seepage that contributes to water logging. Notably, the public sector has to play a leading role in both development and maintenance of drainage system and lining of watercourses, because these are essentially a public good, and require large investments. In addition, communities can be mobilized to maintain and improve the irrigation structures. In this context, the success of RSPs in organizing communities to build and maintain infrastructure has been encouraging.

5.81 Since private on-farm investment can also substantially reduce land degradation, an important policy intervention would be to create an environment that encourages such investment. Evidence suggests that security of tenure and ownership of land have significant effect in this regard, which further reinforces the importance of land and tenancy reforms. Indeed, as noted throughout this chapter, it is important to emphasize that strong inter-linkages exist among the main policy concerns with respect to the rural economy and rural poverty, and which must be addressed in a coordinated fashion if a rural poverty strategy is to be effective.

## **Conclusion**

5.82 As first noted in Chapter 1 of this report, Pakistan currently finds itself caught between two apparently competing constraints. On the one hand it confronts a social gap that has undermined growth and limited the country's ability to alleviate poverty, and on the other, it must service its substantial national debt, servicing which absorbs most of the public resources that might be used to close the social gap.

5.83 Yet as this report has argued, policies that would force a trade-off between fiscal viability and human development are unlikely to be sustainable or successful on either of these fronts. If Pakistan does not close its social gap, its long-term ability to grow economically and to sustain its debt are slim. The

report points to serious gaps in what is known about poverty, growth and human development in Pakistan. Nevertheless there is already considerable available information and more is being gathered. It indicates that in part, in so far as they cut across social, macroeconomic and fiscal domains, Pakistan's current problems denote a wider crisis in governance.

5.84 To a great extent, these underlying problems have prevented the country from making better use of its scarce resources, much as they have also impeded private sector growth and discouraged private investment. Unless these problems are rectified, large infusions of donor assistance, whether in support of private sector activities or social goals, are unlikely to produce the desired impact, as shown already by the relative failure of Pakistan's Social Action Program. Despite the uncertainties associated with recent political changes, this appears to have been recognized by its government, which has responded with the recent devolution reforms.

5.85 To tackle the outstanding issue of poverty in Pakistan and its concomitant social gap, this chapter accordingly identified a number of strategies and tactics focused particularly on institutions. These included expansion of microcredit to improve access to credit, community organization to manage rural resources, and governance reforms to improve access to services. The poverty focus of the economic reform program as articulated in the PRSP encompasses many of the elements highlighted here. Sustaining the current impetus of reforms and implementing comprehensive, mutually reinforcing interventions to spur growth, reduce poverty, and promote human development remains an enduring challenge for stakeholders in the country's development, including the World Bank.

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<sup>1</sup> World Bank (1995)

<sup>2</sup> At present, zakat collections amount to Rs. 5 billion, and reaches around 2.5 million beneficiaries – a small fraction of the population that is in need of such assistance.

<sup>3</sup> World Bank (1995) and Jehle (1995). Further, estimates based on HIES (1996-97) data indicate that only around 29 percent of the direct benefits went to the bottom expenditure quintile among households

<sup>4</sup> See SPDC (1999), Subbarao et al (1997).

<sup>5</sup> As reported by the I-PRSP (2001)

<sup>6</sup> By June 1997, more than 37,000 employers were making contributions for 1.2 million registered workers, supplemented by a federal grant of up to Rs. 1 billion every year.

<sup>7</sup> Examples include large initiatives like the Rural Works Program (1962-72), and the Peoples Works Programs (1972-83), neither of which fulfilled its role in creating infrastructure and providing safety nets to the poor during times of stress (see Naseem, 2000 for a discussion of the history of Works programs)

<sup>8</sup> As reported in Interim-PRSP, GOP (2001)

<sup>9</sup> The FFW program in Bangladesh is a case in point.

<sup>10</sup> The Employment Guarantee Scheme (EGS) in Maharashtra state of India is an example where risk mitigation benefits are high due to such a record.

<sup>11</sup> UNDP (1998)

<sup>12</sup> The World Bank and the Asian Development Bank have partially contributed to the funding of the PPAF and Khushali Bank initiatives, respectively.

<sup>13</sup> Depending on the type of license each would qualify for, these institutions must have a minimum paid-up capital of Rs. 50 million to Rs. 1 billion.

<sup>14</sup> E.g. Korangi Township in the 1960s, Zakat Housing in the 1980s

<sup>15</sup> While the overall urban population growth rate is around 5%, informal settlements or katchi abadis are estimated to grow at over 9% percent per year, with an upward trend (Nasseem, 2001). It is estimated that in Karachi, 40% of population lives in katchi abadis, which accounts for about half of all those living in such urban settlements in Pakistan.

<sup>16</sup> Largely inspired by the success of the OPP, a number of housing programs for upgrading the katchi abadis have been initiated in recent years, especially in the sanitation sector. These include large programs in Karachi, Sukkur, and Hyderabad; there has also been OPP collaboration with NGOs in a number of places like Lahore, Faisalabad, Okara, and Gujranwala.

<sup>17</sup> See, for instance, report by SPDC (2000)

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<sup>18</sup> Donor financing and technical assistance for SAP, amounting to about 20% of the total expenditure, has been available since 1993/94 and has been an important driving force in its implementation.

<sup>19</sup> Proportion of population without access to safe water has fallen from 50% in 1992-93 to 40% in 1995, and proportion of those without access to adequate sanitation has fallen from 67% in 1993 to 53% in 1995. There have also been some increase in life expectancy at birth and rate of use of contraceptives, along with small reductions in fertility and population growth rates.

<sup>20</sup> See, for instance, results from a field survey conducted by Ercelawn and Zaidi (1999). They also found little evidence of NGO involvement in SAP, contrary to one of its stated aims – indications were that NGOs had little or no contact with SAP-related elected and non-elected members.

<sup>21</sup> Moreover, Naseem (2000) quotes unofficial reports from a probe conducted by the Army, that refer to the existence of hundreds of such schools (some of which were used to keep the livestock) along with thousands of absentee teachers who were found drawing salaries on regular basis.

<sup>22</sup> The initial subsidy was Rs. 100 per month per girl enrolled, with an upper limit of Rs. 10,000 per month.

<sup>23</sup> See Alderman et al (1999).