

1. Looking Beyond the Deficit: Social Gaps and Sustainable Development in Pakistan

1.1 Pakistan's fiscal deficit is the subject of much concern. Servicing the country's public debt absorbs a disproportionate share of public resources, renders it vulnerable to debt traps, and dampens economic growth. Yet as argued in this report, in terms of its impact on development and poverty reduction, Pakistan's fiscal deficit is overshadowed by a wider, and in the longer run, much costlier gap - a social one.

1.2 Over the last few decades, economic growth in Pakistan has not produced commensurate social improvements. The country's social indicators are both below those of other developing countries with similar per capita incomes and have improved more slowly than those of countries with similar growth rates. The social gap is intimately linked to Pakistan's persistently high incidence of poverty over the 1990s - particularly in rural areas. Growing evidence also suggests that not only has economic growth not narrowed the social gap, but that the social gap itself is partly responsible for the slow-down in economic growth in the 1990s. The social gap is therefore a critical long-term constraint on sustainable development *and* poverty alleviation.

1.3 In October 1999, a major economic reform program was launched by the Government of Pakistan to address the macroeconomic and structural constraints that impede economic and social progress. In many respects the content of this reform program recognized this social gap and introduced mechanisms to reduce it. Over the last three years, such reforms have brought about macroeconomic stability accompanied by wide-ranging sectoral initiatives to spur economic growth. Even more important from the viewpoint of addressing the social gap is the devolution program which, when successfully implemented, holds promise for improved access to critical public services for the poor. In addition, the poverty reduction strategy prepared by the country highlights needed improvements in education, health and water sectors.

1.4 The analysis in this chapter identifies the macro economic and public expenditure policies over the previous decade that impinged on the social sectors. It highlights the critical challenges that the ongoing reform program will need to incorporate to reverse the trends particularly in poverty and human development. The chapter introduces and places in a cross-country context themes that are documented more fully in the remainder of the report. The main theme is that social services are significantly underprovided in Pakistan, whether one uses as a benchmark either countries with similar per capita incomes or countries with similar records of growth. As argued, the predominant explanation for this is that fiscal policies and practices pursued since 1980 (or earlier), have been characterized by a notably low social spending, on the one hand, and by poor implementation on the other.

1.5 An important argument of this chapter is that these patterns of misallocation and inefficiency in public spending are the result of skewed incentives confronting political decision makers, which have reduced their interest in supporting certain kinds of public programs and actions that would improve the welfare of all Pakistanis, including the poor. This includes neglect of improving universal access to and the quality of schooling and health. Moreover, these incentives have also impeded efforts to reform the governance environment, in order to address inefficiencies in the implementation of fiscal policies that appear to affect all public sector spending in Pakistan.

Poverty, Growth and the Social Gap

1.6 The social gap can be shown most starkly by looking at the extremes. Between 1950 and 1999, the country enjoyed annual average per capita income growth of 2.2 percent, tripling the average income of its citizens, which by 1999 exceeded that of a third of the world's other countries. From 1960 to 1998, the country was also the world's third largest recipient of official development assistance, lagging only India and Egypt. During this time it received \$58 billion in aid, including 22 IMF and World Bank adjustment loans, and considerable bilateral assistance from the United States and other countries.¹

1.7 Despite this, Pakistan's social indicators have failed to match its economic progress. Some have actually deteriorated over time. For instance, female primary school enrollment is 40.5 percent lower than in comparable countries. Social indicators in rural areas are also lagging. At 47 percent, for instance, poverty in the rural NWFP province is more than twice that of urban Sindh, at 19 percent.²

1.8 Lack of education and access to health and other public services are closely and causally related to material poverty. For example, at 43 percent, the illiterate, especially in rural areas, suffer a far higher poverty rate than the college-educated, at 6 percent. If one is to address poverty in Pakistan, it is therefore imperative to focus on bridging its social gap, bridging differences among rural areas and provinces, and men and women.

Income and the Social Gap

1.9 Lagging social performance cannot be completely explained either by the idea that as a poor country, Pakistan does not have the resources to do better, or that it has not grown fast enough to make up for its relatively poor initial social conditions. Table 1.1 shows the lag in health indicators in Pakistan compared to other countries at its income level. It has 36 percent lower births attended by trained personnel, 11 percent more babies born with low birth weight, 42 percent lower health spending per capita, 1.6 percent less of GDP spent on public health, 27 more infant deaths per thousand, 19 more child deaths per thousand, and a 23 percent lower share of population with access to sanitation.

1.10 As shown in Table 1.2, the country's relatively poor education performance disproportionately affects girls and women. Relative to what one would expect given the country's income per capita, it has 20 percent fewer children of elementary school age enrolled in primary school. This gap is entirely due to the disparities in the education of girls: 40 percent fewer girls of elementary school age attend primary school than in countries with comparable incomes. Similarly, the 14 percent shortfall in secondary enrollment is explained mainly by the 20 percent shortfall for females. Tertiary enrollment is also unusually low, although equally so for both males and females. There are nearly 5 more students per teacher in Pakistani schools, in part because public spending on education is 1.4 percent lower than expected. All of these figures are reflected in high rates of illiteracy, particularly for women: the share of the population that is illiterate is 24 percent higher than one would expect based on Pakistan's per capita income; the figure is 32 percent for women.

Table 1.1: Health indicators in Pakistan relative to comparable countries

Variable	% difference between actual indicator and indicator consistent with Pakistan's income per capita
births attended by trained personnel, 1998	36.54
percent low birth weight 1990s	11.63
log(health spending per capita PPP\$ 1990s)	-0.56
public health spending as percent of GDP 1996	-1.62
infant mortality 1998	27.43
under-5 mortality 1998	18.95
Hospital beds per 1000 people 1990s	-1.57
% of population with access to sanitation 1990s	-23.73
% of rural population w/ access	-25.07
% of urban population w/ access	-17.23

Table 1.2: Education indicators in Pakistan relative to comparable countries

Variable	% difference between actual indicator and indicator consistent with Pakistan's income per capita
gross primary enrollment 90s	20.84
Female enrollment	-40.50
male enrollment	-2.19*
gross secondary enrollment 90s	-13.60
Female enrollment	-20.47
male enrollment	-9.03
illiteracy rate 90s	24.42
Female	32.18
male	16.29
Daily newspapers per 1000 people, 1995	-14.08
public spending on education as percent of GDP, 1990s	-1.37
pupil teacher ratio 1989-97	4.63

Note: The percentage is the coefficient on the Pakistan indicator variable in regressions of the health/education variable that also control for per capita incomes over the relative time period (*negative number means Pakistan's actual indicator is less than that predicted by its income*). The coefficients are all statistically significant at the 5% level.

Growth and the Social Gap

1.11 Countries that grew at a rate comparable to Pakistan over the past two decades also achieved greater improvements in social indicators, as figures 1.1 and 1.2 demonstrate. The charts indicate changes in infant mortality and the gap between female and male illiteracy in the relation to moderate growth in incomes of selected countries.³ Infant mortality in the control group declined by 73 percent from 1960 to 1998. In Pakistan, the same amount of growth resulted in a decline less favorable by 43 percent, as shown in Figure 1.1. Figure 1.2 shows that the difference between female and male illiteracy in Pakistan actually increased from 1970 as income per capita increased, while it declined sharply in the group of other countries.

Figure 1.1: Income and infant mortality in Pakistan and comparison sample, 1960-98

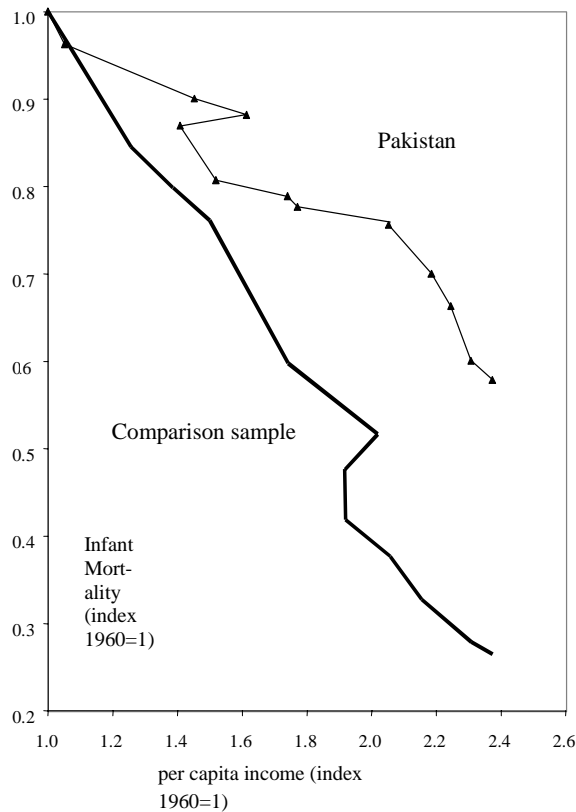
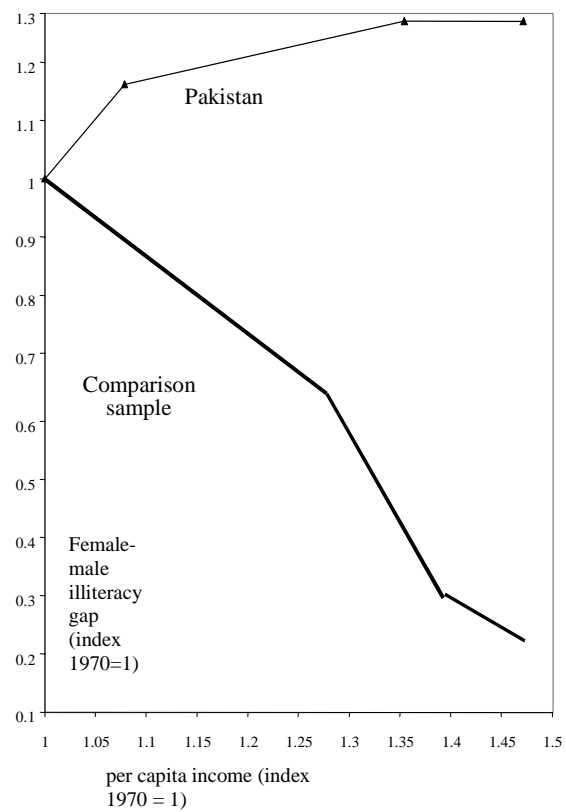


Figure 1.2: Income and female-male illiteracy gap in Pakistan and comparison sample, 1960-98



Regional Comparisons and the Social Gap

1.12 As Table 1.3 shows, Pakistan’s record falls short of countries with similar incomes and growth patterns, including other countries in the region. School enrollment is less, adult illiteracy greater and the infant and child mortality rates higher than in Bangladesh, India and Sri Lanka. The earlier income comparisons are equally valid here. Bangladesh, a poorer country than Pakistan, exhibits social indicators that are in some cases substantially better (infant and child mortality) and in no cases significantly worse than Pakistan’s.

Table 1.3: Regional Comparison of Select Human Development Indicators

	% of children (age 11-15) currently enrolled in school*		Adult Illiteracy (age15+), 1999/2000**		Mortality rate per 1000 1998/99**	
	Male	Female	Male	Female	Infant	Under-5
Bangladesh	62	66	48	70	73	96
India	73	58	32	55	70	83
Pakistan	63	41	42	73	83	116
Sri Lanka	.	.	6	11	15	19

Note: All Pakistan figures are for 1998-99 (PIHS). Sources for other countries are as below:

* Bangladesh: 1995-96 (HIES); India: 1995-96 NSO 52nd round; ** World Development Indicators

Intra-Country Disparities and the Social Gap

1.13 The above tables and figures conceal significant disparities among regions and rural and urban areas, which are in many instances at least as stark as the differences in performance between Pakistan and other developing countries. For instance, Pakistan's social gap with respect to female primary school enrollment is nearly of the same magnitude as the urban/rural gap in the Sindh province, where only 25 percent of girls living in rural areas are enrolled, compared to 62 percent in urban areas.⁴ Similarly, while female literacy stands at only at 55 percent in urban Sindh it reaches the low of 11 percent in rural NWFP, and 7 percent in Balochistan. While access in Pakistan to rural sanitation - drainage - is already 25 percent lower than in countries with comparable income levels, there are gaps of 40 percent across its regions. For instance, only five percent of rural residents of Balochistan have access to drainage.

Explaining the Social Gap: Inadequate Social Spending

1.14 Pakistan's fiscal policies do not reflect the imperative of improving social indicators. Per capita health expenditure, for instance, is currently only \$2 – well below regional and international comparators. This is partly due to the constraints imposed by the country's heavy debt burden and unusually high defense expenditures. Social spending seems to have borne the brunt of the adjustments to these other expenditures.

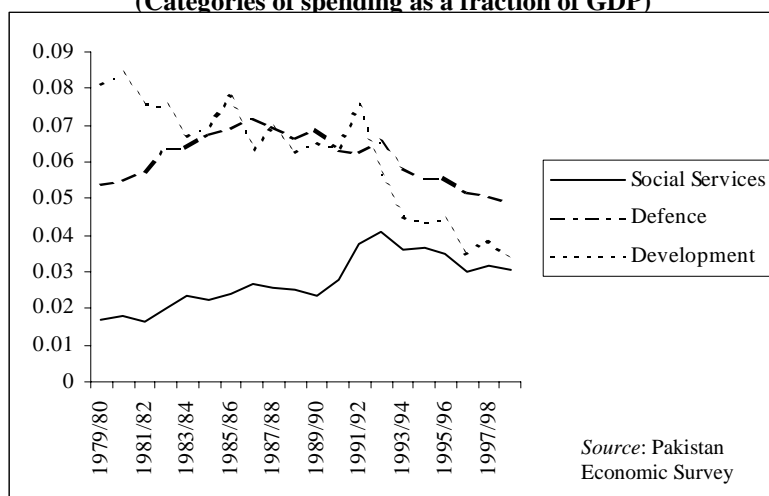
1.15 The problems in public service delivery can be linked to the fact that social spending has suffered in the competition for the allocation of public spending. For the past two decades a rising debt service burden along with continued substantial defense expenditure in the face of stagnant revenues has left little fiscal capacity to meet the rising needs of basic social services. During the 1990s, overall government revenue fell from 17 percent of GDP in 1991 to around 16 percent in 1998 and 1999. Even though defense spending fell from 6 percent of GDP in 1991 to below 5 percent in 1999, interest expense rose from 5 percent to 7.3 percent over the same period. In fact, from 1987 to 1999, the non-interest component of the government budget fell from 22 percent of GDP to 15 percent. Indeed, devising fiscal remedies and securing new financing to enable the government to service its external and domestic debt and to cover its projected deficit has preoccupied recent administrations.

1.16 In the first four decades of Pakistan, other types of “discretionary” spending, such as public investment, have historically fared better than social spending on health and education in the competition for resources. As Figure 1.3 shows, throughout the 1980s, social spending – comprising largely of recurrent spending on items such as teacher salaries, textbooks and medicines – hovered around 2.5 percent of GDP, while development spending – largely for public investment or infrastructure such as roads, irrigation and buildings – consumed around 7 percent of GDP. This gap between development and social spending significantly reduced after 1991-92, as shown in Figure 1.3. The fiscal compression

due to the rise in the interest rate and fall in fiscal deficit was absorbed by a fall in development expenditure. The relative insulation of social spending from downward pressures during this period was largely due to an infusion of \$2 billion in external assistance from 1993-98, in support of the Social Action Program. Even with the additional funds, however, the country's per capita allocation of \$2 for health and \$8 for education is clearly insufficient and less than the amount envisioned when the SAP was conceived.

1.17 Looking across the decade of the nineties, development spending fell from 6.4 percent of the GDP in 1991 to 3 percent in 1999 – a level slightly higher than that of social spending – partly contributing to a reduction of the overall fiscal deficit from around 9 percent to 6 percent of GDP over the same period of time. Even so, cross-country comparisons indicate that social spending continued to remain insufficient. For example, education spending was approximately 1.8 percent of GDP in Pakistan in 1998 but public investment was still 2.5 percent of GDP. In Sri Lanka, on the other hand, education spending was 5.3 percent of GDP, compared to a public investment of 2.6 percent of GDP. In short, Sri Lanka devoted almost twice the resources to education as to public investment; Pakistan dedicated less than 75 percent, even after the apparently precipitous decline in development expenditures in the 1990s.⁵

**Figure 1.3: Social service expenditures in Pakistan
(Categories of spending as a fraction of GDP)**



**Table 1.4: Benefit of Public Education Spending
Per Capita: 1998-99⁶**

Per Capita Consumption Exp. quintiles	% Shares		
	Primary	Secondary	Tertiary
1	185	55	10
2	219	85	27
3	194	101	39
4	180	124	65
5	110	122	187
Average	178	97	65

Source: PIHS (1998-99)

Table 1.5: Distribution of Public Expenditure on Education: 1998-99

Per Capita Consumption Exp. quintiles	% Shares			
	Primary	Secondary	Tertiary	Total
1	20.9	11.4	3.1	14.8
2	24.7	17.6	8.1	19.5
3	21.9	20.7	11.8	19.6
4	20.3	25.5	19.9	21.7
5	12.3	24.9	57.0	24.5
Total	100.0	100.0	100.0	100.0

Source: PIHS (1998-99)

1.18 The relative lack of attention to social spending in Pakistan has had particularly adverse consequences for the poor, since social services tend to benefit the poor disproportionately. For instance, in the case of Pakistan, a rough benefit-incidence analysis of public expenditure on education reveals that spending on primary education, in particular, is strongly pro-poor (Tables 1.4 and 1.5). This is however not the case for spending on secondary and tertiary education, primarily because of the low participation of the poor at such levels.

1.19 It is important to note that the static benefit-incidence presented above is quite limited in regard to measuring the impact of public spending. In particular, such an exercise takes the usage rate of public

services as given, not taking into account the dynamic effects of spending an additional dollar on the use of public services.⁷ Thus Tables 1.4 and 1.5 are merely indicative of the importance of the *nature* of social spending from the point of view of its impact on the poor.

1.20 The critical importance of the nature and quality of public spending in determining social indicators is also highlighted by a recent World Bank study of local public expenditures for Punjab, the most populous province in Pakistan (Box 1.1). The study indicates that the province's poor social indicators result not only from low spending on the social sector, but also from inefficiencies in the use of the limited resources thus provided. This kind of analysis is needed for the country as a whole, and will be conducted as a part of the planned Public Expenditure Review for Pakistan in the near future.

Box 1.1: Patterns of Low and Inefficient Social Spending: The Case of Punjab

Home to close to 60% of Pakistan's population, Punjab province is a microcosm of the social gap in the country. According to a recent World Bank study of local public expenditures, the province's poor social indicators result from a) low spending on the social sector and b) inefficiencies in the use of these limited resources.

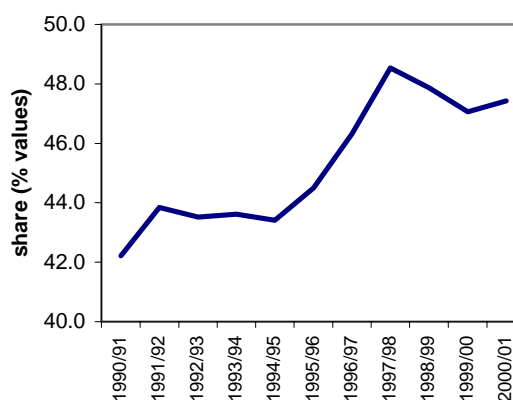
Punjab's educational budget, at about 2.1% of provincial GDP, is only about half the share allocated by countries with similar incomes, and about two-thirds of what is spent in neighboring India and Sri Lanka. Actual spending is even less than these budget targets indicate, falling short by as much as a quarter in recent years. Despite the explicit aim of the Social Action Program to boost expenditures, average real spending per student was stagnant during the 1990s. The amount allocated to non-salary inputs such as teaching materials, a critical determinant of school quality, has also remained very low – in 1997/98, 97% of the elementary education budget was spent on teacher salaries. Moreover, restrictions on the use of the non-salary budget – particularly withholding funds from School Management Committees (SMCs) that do not have a member trained in the use of public funds – have resulted in underspending of the already limited budget allocations for non-salary expenditures.

Punjab's health expenditure of approximately 0.5% of provincial GDP is similarly low by international standards – the average expenditure for all low and middle-income countries is roughly 2% of GDP. At about a third of total expenditures, allocations for non-salary inputs are insufficient, with the result that government health facilities routinely run out of medicine and other supplies. For example, in the last quarter of 1999, half of the primary health care facilities in the province reported that supplies of three essential drugs had been completely exhausted.

Source: Pakistan: Reforming Punjab's Public Finances and Institutions (World Bank, 2001)

1.21 Given that, as mentioned before, aggregate social sector spending has been deficient in Pakistan, it will be particularly important to improve the impact of such spending on the poor. Expanding the share of primary education in education spending is one example of ways to ensure such impact. To see where Pakistan stands in this regard, it is useful to look at the pattern of distribution of education spending over the years. As Figure 1.4 shows, the share of primary education in education spending evinces an increasing trend during the 1990s. While of late this share has declined somewhat, by and large education spending has grown more pro-poor since the mid-90s, with an increased focus on primary education.

Figure 1.4: Share of Primary in Public Spending on Education: 1990s



Problems of Public Sector Management and Implementation

1.22 As the case of the Punjab illustrates, poor management and implementation have exacerbated the ill effects of scarce allocations for social programs in Pakistan. This was also the case for the Social Action Program that was launched in the mid 1990's by the government and donors, to improve education and health outcomes in Pakistan. Resources that were allocated to social spending over the past decade under the aegis of this program were used inefficiently, and failed to have the expected impact on a rupee per rupee basis.

1.23 As detailed in this section, Pakistan in fact exhibits persistent problems in many dimensions of governance that are relevant for sound public spending: leakage, licit and illicit; difficulties with bureaucratic structure and quality; weaknesses in the rule of law, and opacity in government decision making. The World Bank's recent Pakistan Development Policy Review confirms the importance of these problems, which have also been recognized by the Pakistani government in the context of its devolution reforms and I-PSRP.

1.24 These and other issues specific to health and education in the 1990's are treated more extensively in Chapter 4 of this report. However, implementation problems are a daunting challenge in social policy in part because they are endemic across all areas of public policy in Pakistan. This section reviews some of these other implementation failures, ranging from public investment to economic policy reforms, which have themselves undermined the resources available for social spending, either directly (waste in public investment) or indirectly (flawed and incomplete implementation of liberalization, stifling the expected growth benefits).

1.25 For instance, the large infrastructure component of public expenditure in the eighties did not generate benefits commensurate with their cost. This was, in the first instance, because many of the projects were not conceived with broad economic and social goals in mind. Their benefits were further reduced because operations and maintenance budgets did not keep pace, which eroded the growth creating potential of such investments.. Therefore, instead of promoting growth, development expenditures in the 1980s simply added to the growth-suppressing debt burden of the 1990s. That is, development expenditures in the 1980s, which could have been growth promoting and expanded the envelope of resources available for social spending, instead shrunk the envelope.

1.26 Roads and irrigation provide examples of this neglect. Between 1987/88 and 1994/95 federal maintenance expenditures as a percentage of network requirements for Pakistan's National Highway System fell from 52 percent to 34 percent (World Bank 1997b). A 1998 survey revealed that two-thirds of the national highway network was in poor or very poor condition (World Bank 1998d). Currently, maintenance allocations are estimated at 75 percent of requirements in Punjab, and 50 percent in NWFP, Sindh, and Balochistan, resulting in a backlog estimated at 20 percent of the total network length at the federal level, and 30-50 percent at the provincial level. For investments in transport infrastructure to pay off, they must reduce transport costs. There is little evidence that this has been the case here, at least over the medium- and long-term.

1.27 Data from irrigation reveals similar patterns. In Punjab, the gap between O&M requirements and actual expenditures is roughly 30-40 percent, resulting in poorly maintained drains, distributional and link canals, and barrages (World Bank, 2001). As a result there are considerable delivery inefficiencies; only 35-40 percent of available supplies reach the fields. There are also inequities in water availability, in particular shortages at the points farthest from canal heads, and waterlogging and salinity that ruin large areas of productive land.

1.28 Efforts to reform the economy have also been undermined by related governance issues. Although successive civilian governments in the late 1980s and early 1990s introduced extensive measures to liberalize trade in order to encourage export-led growth, an anti-export bias remains. Successive rounds of tariff reforms reduced the maximum tariff rate from 225 percent in 1988 to 45 percent by 1997 and quantitative restrictions were lifted on 332 of 400 items. However, the tariff structure continued to be characterized by substantial differences among rates. This resulted in large and unpredictable *de facto* differences in effective protection across commercial sectors and activities. For example, imports of plant and machinery competing with the domestic engineering industry were charged a rate of 35 percent, as compared to the 10 percent tariff on non-competing capital goods (World Bank 1998b).

1.29 The tariff regime sent mixed signals to producers and exporters. The complexity and non-transparency of the tariff regime was further exacerbated by ad-hoc exemptions and concessions, which allowed considerable scope for discretion and corruption in customs administration. Exports rose from approximately 10 percent of GDP in 1985 to approximately 15 percent in 1995; but they have stagnated since. In keeping with the spirit of the economic reform program, the current government has rationalized the existing tariff structure to reduce duties on a range of imported inputs for domestic industry. In addition, the tariff structure has been substantially simplified, which is expected to improve valuation, clearance, and customs administration, thus addressing the aforementioned problems of non-transparency and governance

1.30 Problems of implementation also arise due to lack of management capacity in the public sector. In the opinion of many within the Government the quality of the civil service has steadily eroded over time. A recent World Bank study (1998a) pointed to a over-staffed and under-skilled civilian bureaucracy; an over-centralized organizational structure and inappropriate skills mix; seriously eroded internal accountability and lack of accountability to the public. This was exacerbated by widespread corruption and excessive political interference in the functioning of the civil service. Since 1999, the government has adopted a strategy that addresses the aforementioned concerns. The strategy involves giving more autonomy to the Federal Public Services Commission to enhance its independence and improve accountability for merit-based recruitment and other personnel management decisions. Public financial management has been much improved by structural reform and the use of Ad Hoc Public Accounts Committees. Furthermore, the National accountability Bureau has been established with powers to investigate and prosecute, which is expected to enhance accountability and reduce corruption.

1.31 To some extent, political factors may also impede implementation of public sector policies. For instance, public expenditure allocations, such as the selection of infrastructure projects without sufficient attention to maintenance and sustainability, may be driven by incentives that govern local political dynamics. Further discussion of such local dynamics follows below.

Political Economy and Social Spending: A New Hypothesis

1.32 Pakistan is currently implementing or contemplating the implementation of substantial political restructuring, including devolution. A key motivation of such reforms is to improve the performance of the Pakistani government in serving the needs of its citizens – most of who are poor and have had little access to social services compared to the poor in other, similarly- situated countries. The effectiveness of these reforms, both those that are underway and are currently contemplated, depends on the degree to which they address the incentive problems that seem to have driven past allocation and implementation decisions in fiscal policy, as discussed below. That is, future reforms will succeed to the extent that they correct the problems in political economy that have undermined past policies.

1.33 Traditional explanations of the incentives of political decision makers in Pakistan have focused on elite capture of the state and the fractionalization of the society. The elites, benefiting little from public spending directed at the poor, and in some cases threatened by it (education), were said to block fiscal reforms. Evidence reviewed here suggests a different story. Elected legislators were very concerned about demonstrating their effectiveness in delivering government benefits to constituents. However, their incentives were such that they focused attention on goods and services that could be targeted as patronage to supporters - such as infrastructure - rather than true public goods, like universal access to public education or the rule of law and bureaucratic quality (key to successful implementation). Their incentives to improve education and health were further dampened by demand issues: the low support among some voters for these services, particularly for girls.

Traditional explanations of the political economy of the social gap

1.34 The deepest and most pervasive poverty in the country is rural, and it is worst in areas that have been traditionally considered as “feudal”, such as rural Sindh. A strong association between landlessness and poverty supports this link. Among the 70 percent of the population that do not own any land, the poverty rate is 35 percent, while it is only 13 percent among the 6 percent who owned at least 4 hectares of land. Conversely, 75 percent of the poor owned no land, and among those characterized as poor, only 2 percent owned more than 4 hectares of land. It is not surprising, then, that the first explanations of persistently low social indicators in Pakistan would reference the particular social and economic landscape of rural areas.

1.35 Rural elites have always had exceptional influence in Pakistan - whether by marriage or other family ties to state officials in either military or civilian governments, or because of constitutionally mandated over-representation in the elected legislature. The characteristics of these elite vary. In general, elites have had relatively little interest in enhancing their constituents’ access to education, or in ensuring that the poor could obtain the protection of the law without elite intervention. In some other cases, in particular concerning the poorest parts of rural Pakistan, elected politicians were large semi-feudal landowners, who would have had weak incentives to advocate better government for their constituents.⁸ Prominent in virtually all government coalitions, this “rural gentry” is said to have captured 70 percent of the seats in local elections in December 2000.⁹ Their success until this year in blocking federal taxation of their incomes is cited as evidence of their influence.¹⁰

1.36 The political hold that landlords exert on rural inhabitants is easily overstated. First, landlords are not a monolithic class and compete vigorously among themselves for political office. Many landlords, including the most feudal, lost their parliamentary seats in the 1990s. Second, anthropological evidence shows that rural inhabitants were less reliant on landowners in the 1990s than earlier - if not necessarily by choice. For example, they were less able to turn to landlords for support in the event of family illness since the offspring of traditionally powerful landlord families now spend more time in the city and are unavailable for traditional landlord “services.”

1.37 A careful survey of 125 primary schools in selected rural locales provides one indication that failures in the provision of government services are particularly acute in rural Pakistan, but underlines as well the difficulty of tracing these failures back to landlords. In surprise visits, Gazdar (2000) found that a quarter of the schools surveyed were not open;¹¹ there were no teachers present at all in 19 per cent of them, and only one teacher was present in 35 per cent.¹² Only 38 percent of the schools were classified as “functional”, according to the least demanding of criteria,¹³ only a quarter of the schools had electricity, and only half had a latrine.¹⁴

1.38 Specific landlord influence was visible in several of these cases, but it was neither unambiguously pernicious, nor was it sufficient to explain the pervasive breakdown of the educational system that was

observed. For example, one local landlord worked hard to install a school in his area, but was also obliged to ensure that a female relative received a teaching assignment there. He could not override the familial obligation to keep her employed when it turned out that she did not attend classes. In some cases, school buildings were used for the landowners' personal purposes. However, in other cases, when, for instance, the landlords' children attended the school, they tended to function better.

1.39 It is also easy to overstate the extent to which political and rural elites ignore the poor. Rather, the evidence suggests that they are selective in what they provide the poor. Although rural constituencies have been denied universal access to public services - such as schooling and better health facilities - they do not seem to have lagged in access to other public goods. Potable water (Box 1.2) is an example of elected officials' emphasis on providing targeted benefits. Similarly, new public investments and major rehabilitation projects are preferred over more cost-effective maintenance

Box 1.2: The Paradox of Access: Water, but no Education

Potable water can be targeted to specific groups, giving it many of the characteristics of a private good. Moreover, water projects have high value in terms of job provision, another private good. Finally, once potable water systems are constructed, access to them and their continued viability are not particularly vulnerable, in the way that education is, to patronage-driven political decisions. The provision of water projects would seem, therefore, to be consistent with political incentives in Pakistan. In fact, compared to countries with similar incomes per capita and population characteristics, access to potable water in Pakistan in 2000 was 25 percentage points higher than expected - compared to 20 percentage points less in the case of primary school enrollment.

1.40 Accordingly, it appears that regardless of whether they are elected or non-elected, public officials in Pakistan have historically not ignored their constituents, including poor per se, but rather have emphasized providing limited services to them, such as infrastructure. Moreover, as the last section indicates, both in periods with and without elections decision makers have preferred the targeted aspects of infrastructure (such as the ability to use infrastructure projects to provide jobs or contracts) rather than the untargeted spillover benefits. As a consequence, they tolerated very high levels of leakage and inefficiency. To further understand why the poor are unable - and in some instances apparently disinclined - to contest this situation, we need to move beyond the framework of landlord domination of the political process.

Distortions in the competition for the votes of the poor

1.41 Poor performance in public expenditures stretches over the 1980s, with a non-elected government, and the 1990s, with elected governments. The key distinguishing feature of non-elected governments is the inability of citizens to hold them accountable on a regular basis. This leaves such governments freer to pursue policies that were at odds with citizen interests, which seems to have been the case of public expenditure policies in the 1980s. However, going forward, and in view of the importance of elected local governments under devolution, the important phenomenon to analyze is the source of poor governance of public expenditure under the elected governments of the 1990s.

1.42 From the point of view of citizens, the preferred political candidate or party is - in any country - the one that can credibly promise the best public services at the least cost. The first difficulty in electoral politics has been that political parties have not been able to make credible claims regarding their performance in service provision. In office, neither of the major parties worked hard to improve service provision. Also, in electoral campaigns national policies towards service provision and other broad policy issues are rarely raised.

1.43 As a consequence, from the point of view of citizens whether rich or poor, the only guarantee of government responsiveness comes from the presence in government of some official with whom they have a personal connection. This means that the success of legislators or other politicians depends on their personal reputation for providing goods, jobs and government access to individuals with whom they have had contact. Such legislators have little interest, as a consequence, in providing public goods that benefit a broad range of the public.

1.44 The second characteristic of electoral politics in Pakistan that undermines the provision of public services to the poor is the impermanence of elected governments. This shortens the political horizons of decision makers, and reduces the penalty to them of renegeing on any electoral promises that they do make. Notably, in other countries, where political parties are well developed and constitutional government has been observed over several electoral generations, the costs to political parties of renegeing on policy promises are much higher. Hence, policy promises of parties are much more important, electorally, than they are in Pakistan, and the role of individual relationships in politics is much less.

1.45 The local elite are often powerful because they *can* make credible promises to local residents. They have a local reputation that is independent of the comings and goings of national governments. The ability of local voters to trust local representatives is not a solution to all problems, as the experience of Pakistan in the 1990s clearly shows. Local elites may not be competitive. Although, in principal, any local resident could develop a relationship for helping others and of intermediating successfully with government, in more feudal areas of the country the local elite could easily discourage competition. Even if local elites compete with each other, none has an incentive to make promises regarding government expenditures that benefit people outside of their area, since they cannot get credit for such policies. Nor do they have an incentive to make promises that will not yield short run benefits realizable before the fall of the government in question. Finally, even within their community, they have an incentive to favor those with whom they have a personal or family/*biraderi* (kinship group) relationship, exactly because personal relationships are the most important currency of political competition. Accordingly, they have a strong preference for making promises about infrastructure, or to solve specific problems (such as conflicts with the police) rather than systemic problems (the quality of policing in a jurisdiction).

Box 1.3: Politics, rent-seeking and local elites: the nexus between a *nambardar* and the police

The *nambardar* of the village Akalipur in Faisalabad – one Shahid Jat – saw his role as being a mediator between the residents of the village and state authority. According to him the most important problem for which people asked his help was dealing with the police. Without some form of intermediation the police did not pursue any case. According to Shahid his main advantage as an interlocutor was his position as *nambardar*. This gave him access, but thereafter he had to rely on his social connections and tactics in order to obtain results. Shahid Jat was also a key player in electoral politics of the village and was regarded as the head of one of the two factions that contended for position.

Local opinions about Shahid Jat and his intermediary activities were divided along factional lines. It was generally accepted that Shahid took money in order to get work done through the police. His supporters were of the view that money was required in order to bribe the police. His opponents thought that Shahid acted as a commission agent for the police. They accepted that the police did charge bribes for simple matters, but were of the view that it was possible, also, to get things done through political connections and leverage. They held that Shahid was justified in charging commissions from other people but that he ought to work for people free of charge, on the basis of social and political goodwill. He could either demand money for his intermediation or ask for a vote, but not both. In the recent elections Shahid was defeated.

Source: Gazdar (2002). "A Qualitative Survey of Poverty in Rural Pakistan: Methodology, Data, and Main Findings"

1.46 Box 1.3 illustrates the position of the local elite, the role they fill in intermediating with authorities outside of the community, and the political opportunities available to them because of their local role as social and political intermediaries. It also demonstrates that local elites may have to make a tradeoff between using their position to launch a political career and using it to extract rents from local citizens.

1.47 The importance of locally important people in the political calculations of national and provincial government leaders is evident in the efforts that these leaders make to recruit them as candidates for elected office; to secure their endorsement when elections take place; or simply to secure their cooperation in the implementation of public policy. Indeed, governmental concerns about the behavior and allegiances of local elites have been evident in every government, extending to the most recent local elections.

1.48 These characteristics of political competition in Pakistan explain why spending on infrastructure, such as market roads and water, is large in proportion to the share of the total population living in rural areas. These public goods have two important distinguishing characteristics: they provide immediate and easily assessed benefits in the form of construction jobs and flow of services – especially important where political instability is great and current politicians are unable to credibly promise future benefits to constituents. And they can be narrowly targeted to supporters – especially important where voters, particularly rural or poor voters, perceive that their ability to obtain goods and services from the state depends on personal relationships.

1.49 Public goods such as universal access to education and health, including broad improvements in the quality of teachers or curricula, do not share these two characteristics. As public goods, improved curricula and better oversight of school performance can less easily be targeted and are not easily sustained over a long period of time without additional effort. Moreover, the benefits of political efforts to maintain highways or improve school quality are difficult for constituents to perceive in the short run, further reducing their utility to policy makers with short horizons. More importantly, the larger and more concentrated the effects of an expenditure, the easier it is for constituents to give credit for it to their personal representative. Small expenditures, such as maintenance on a highway in good condition, could as easily be the product of some government-wide policy with which the local representative has had little to do.

1.50 The incentive structure that induces elected officials to under-supply public goods should not be viewed as an indictment of democratic politics per se, since it is not necessarily a characteristic of other democratic systems around the world. Many democratic governments, such as the state of Kerala in India, have emphasized investments in education and health. It is rather the specific informal rules of electoral competition in Pakistan that has uniquely shaped the incentives of the legislators. In any case, non-elected governments in Pakistan have traditionally placed no greater weight on the welfare of the rural poor than have elected governments. Second, insofar as local elites are the only interlocutors with the government that the rural poor have at their disposal, their potential marginalization under non-elected governments may not benefit the poor, since the poor have no other way of exerting leverage on national level policy makers and officials, whether elected or military.

The poor and the demand for public goods

1.51 While there are structural reasons for elected officials to expend greater effort on procuring physical infrastructure for their constituents, there is also evidence that their constituents themselves may prefer spending on infrastructure relative to improved education and health. For example, in systematic surveys and, especially, in informal contacts, the rural poor frequently place access to water ahead of improvements in access to and the quality of education. Indeed, the Pakistani poor evidence a very low demand for female education by international standards. Accordingly, political representatives predictably prefer infrastructure spending to service delivery.

1.52 However, if public policy were oriented towards the efficient provision of desired infrastructure, such as water resources and market roads, one would not expect to see empty school buildings, considerable waste and leakage in infrastructure construction, and stark breakdowns in the maintenance

and operation of physical infrastructure once provided. The prevalence of these more negative phenomena suggests that more is at work than skewed demands for public services on the part of the poor. The short horizons of political decision makers and their focus on targeted goods rather than broad public policy issues (such as improved implementation) provide some explanation for these problematic aspects of infrastructure provision.

1.53 While the foregoing analysis argues that the poor do have some, though inadequately transmitted, influence on public policy outcomes, it is still the case that the rich have more significant influence. If they expressed a demand for high quality public services, one might expect these to emerge rapidly. However, it is abundantly clear that the rich have opted out of the public system, as in many other countries, and have not used their considerable political power to improve public policies that benefit the poor.

Dual Constraints: Closing the Social Gap Under Constraint of Fiscal Deficit

1.54 Pakistan's fiscal crisis has captured most of the attention of economic policy makers. And, clearly, its high debt, low growth, and high real interest rate payments are a volatile mix that could lead to explosive debt increases in the near future. In the 1980s and early 1990s, the emerging debt and growth crisis was disguised by substantial external flows. These flows, from international lenders and remittances, dropped off long ago: official remittances from migrant workers declined from over 10 percent of GDP at their peak in 1983 to 2.3 percent by 1996, creating the crisis atmosphere now surrounding the national debt.¹⁵ However, the newly emergent crisis atmosphere surrounding debt is matched by the chronic, but more silent crisis of the growing social gap.

1.55 The argument in this section is not that fiscal objectives should be compromised in order to address Pakistan's social gap. Rather, it is that by attacking the governance problems that are at the root of this gap, Pakistan would work also to spur economic growth that will mitigate the fiscal crisis. In the past, governance problems have precipitated a vicious circle: a focus on fiscal policies that de-emphasized social spending; were implemented with excessive leakage and insufficient attention to efficiency and equity; and eventually gave rise to serious fiscal and social gaps. A different strategy, focused on governance reforms, can create a virtuous circle, in which growth is accelerated and resources are freed for spending, helping to effectively close both social and fiscal gaps.

1.56 Governance problems were the main reason that deficit-funded public investments of the 1980s failed to yield long-term growth dividends. If these dividends had been realized, the debt incurred would now constitute a small fraction of GDP and debt service payments would today be much less onerous. For example, if the \$58 billion in development assistance provided to Pakistan between 1960 and 1999 had been invested during this time to yield a moderate real return of 6%, it would have grown into assets equal to \$239 billion in 1998, and Pakistan's GDP would have been much higher than its present level. Instead, this debt now stands at 92 percent of GDP, and is in and of itself a constraint on growth.

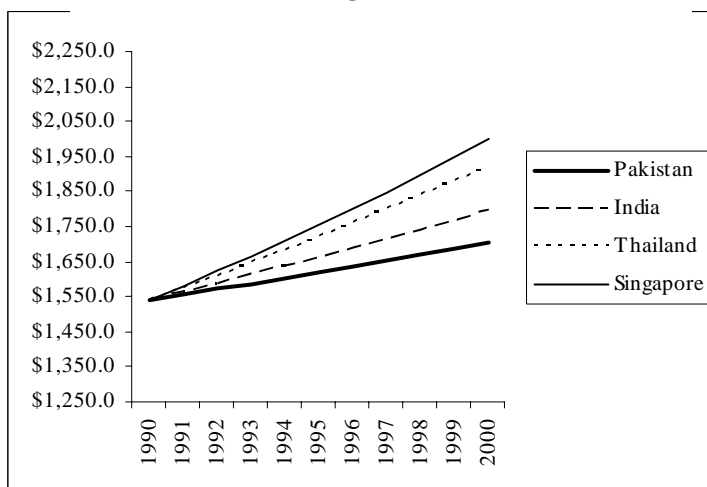
1.57 Governance reforms that are specifically directed at improving the implementation of social spending should close the social gap by increasing the amount of real resources allocated to meeting needs "on the ground." In addition, by closing the social gap, the country should indirectly incur growth payoffs that would increase resources available for debt reduction.¹⁶ One set of estimates looking at the effect of education on growth, controlling for other factors, finds that a ten percentage point increase in secondary school enrollment is associated with a 0.5 percentage point increase in yearly per capita growth.

1.58 Social spending is embedded in the fabric of government and society, however, so successful governance reforms will have to be comprehensive and broad in their scope. Reforms that reduce waste

and leakage in all areas of fiscal policy, especially in development, and that deepen the rule of law have direct effects on the efficiency of spending, which relax the fiscal constraint that exacerbates the social gap. Such reforms also increase growth by expanding the size of the pie available for debt reduction.

1.59 The engine of growth is universally regarded as investment, which is obstructed when the governance environment is weak. Both individuals and firms, poor microenterprise entrepreneurs and multinationals, have borne the brunt of weak governance when they attempt to deal with the police or judicial institutions, or in times of civil unrest that have precipitated serious deterioration in the rule of law, as in Karachi in the 1990s. Just as the poor are forced to compete for targeted infrastructure investments, firms are forced to compete for exemption from onerous regulation or, more commonly, from the arbitrary imposition of unjustified regulatory requirements. Firms see their own labor costs rise and competitiveness decline when their workers lack the educational basics. Firms, like the poor, are exposed to the tremendous insecurities of crime or to abusive behavior by public officials. Like the poor, entrepreneurs understand that success (or, in the case of the poor, avoidance of catastrophe) requires strong personal relationships with government officials who can protect their interests. This is the antithesis of the rule of law and lies at the root of poor service delivery, the vulnerability of the poor, and the reluctance of investors to enter the country even in more tranquil times in which the pressures of international conflict are absent.

Figure 1.5: Governance impacts incomes: benchmarking Pakistan's record



Note: Vertical axis is per capita income. The curves are, respectively, actual Pakistan income per capita, beginning and end of period; and simulated income per capita assessing the effect on Pakistani incomes of the governance indicators of India, Thailand, and Singapore.

1.60 In view of its uncertain governance environment, it is not surprising that Pakistan has failed to reap substantial private investment from its significant liberalization efforts. Governance uncertainties have a strong negative impact on growth, as Figure 1.5 illustrates. The *International Country Risk Guide*, published by Political Risk Services (Syracuse, New York), rates countries according to bureaucratic quality, rule of law and corruption; three key components of the governance problems that afflict Pakistan. A five point increase in the ICRG ratings, on a scale of 1 to 18, is associated with a one percentage point increase in the yearly rate of per capita income growth in the countries surveyed.

1.61 Figure 1.5 quantifies the cost of poor governance for Pakistan.¹⁷ It shows that if Pakistan had exhibited similar performance with respect to the rule of law, bureaucratic quality and corruption as Singapore during the 1990s, per capita income in the year 2000 would have been \$300 higher.

Re-addressing the Social Gap

1.62 The remaining chapters of this report discuss the many specific ways in which government spending and policy decisions contribute to the social gap. They range from allocation concerns in health and education, to a range of barriers to market access that confront the rural poor. However, in designing policies to remove these barriers, continued attention must be paid to the governance environment and to

the incentives of all of the actors whose support is necessary to make reform successful. These policies must also be focused on economic growth, but growth that is more sustainable than that experienced in the 1980s.

1.63 Social sector reforms that ignore the difficulties that the poor face in holding government accountable, and the important role that local elites play in this regard, are unlikely to be successful. The Social Action Program, for example, grew out of recognition by both donors and the Pakistani government that targeted action on social service delivery was needed to address poverty. However, the design of the program did not reflect the obstacles to improved service delivery that existed “on the ground” nor the gap between the reforms that were envisioned and those that either the poor or their political representatives sought to secure. This incomplete understanding of the relevant social and political context meant that the SAP placed excessive emphasis on the creation of parent associations that could not exercise influence, and dedicated insufficient human and financial resources to circumventing and overcoming institutional and social obstacles.

1.64 The lack of accountability can be improved by increased democratization, decentralization, and transparency. However, these labels hide a wide array of potential reforms, only some of which may be useful. In the case of Pakistan, the simultaneous improvement of the investment climate and the prospects for poverty reduction will emerge when narrow groups that have been able to target benefits to their and their constituents’ interests are forced to take into account broader needs, including the needs of women and other disadvantaged groups and classes. Not all democratic governments – and certainly not all non-democratic governments – achieve this. However, growth, development and poverty alleviation demand it.

1.65 While emphasizing the importance of good macroeconomic policies and the need for continuing attention to the fiscal gap – in regards to which particular attention should be focused on promoting growth through governance reforms – the rest of the report will focus on the complementary factors that are critical to ensure that growth benefits the poor. In doing so, successive chapters analyze the most salient social and poverty related characteristics of Pakistan, drawing primarily on household data from various surveys, to identify areas where public policy can make a difference.

1.66 Chapter two provides an anatomy of poverty, exploring its evolution across the 1990s, outlining problems related to its measurement, and discussing dynamic factors that influence how people identified as poor either fall into or escape their circumstances. It also explores the broader dimensions and possible social determinants of poverty; exploring the social characteristics associated with lack of consumption and pointing to the influence of human capital on poverty.

1.67 Chapters three and four more deeply examine the dynamics of the most important social sectors - education and health, and of the most neglected target areas –the rural sector. Chapter three points to the strong impact of educational attainment and health on earnings. Using education as a case example, this chapter outlines how governance problems and political economy considerations impede service delivery, with particularly adverse consequences for the poor. Chapter four identifies the major policy challenges of the rural sector, including the need for a coordinated strategy that address some critical constraints such as access to assets, particularly land, access to credit, non-farm opportunities and infrastructure. Chapter five concludes the report by collating priorities for poverty alleviation, and identifying relevant challenges and lessons for stakeholders, including governments and NGOs.

1.68 The report does recognize the fact that successfully addressing the specific issues noted herein may be conditional on wider reforms being undertaken in Pakistan, as outlined in the recent Development Policy Review. It proceeds on the understanding that it is nevertheless important to broach these issues. Moreover, in this regard, the report closely references the Government of Pakistan’s own I-PRSP,

recognizing the considerable commitment already shown by the government towards addressing the underlying problems discussed in the report.

¹ In 1995 dollars; not counting the adjustment loan the multilaterals are making in the years 2000-2001.

² Headcount index, Pakistan Integrated Household Survey. Further discussion of the scope and measurement of poverty in Pakistan follows in Chapter 2.

³ The control group is chosen as the third of the sample ordered by growth and centered on Pakistan. The initial year income per capita index set equal to unity for all countries. This group is called “comparison sample” in the figures. The index of per capita income and infant mortality are then plotted, set to 1 in the initial year. By construction, the index of per capita income will reach the same point at the end of the period in the control group as in Pakistan: since Pakistani growth over the period is precisely the average of the comparison sample, if all countries start at a common 1960 or 1970 index = 1, and have the same growth rates, they must end at the same index of per capita income in 1998.

⁴ The source of all the regional urban/rural by gender data is the 1998/99 Pakistan Integrated Household Survey (PIHS).

⁵ The World Bank country office is the source for education expenditures in 1998 in Pakistan. *Government Financial Statistics* is the source for the remaining three expenditure information. 1998 is the latest year for which data is available for all variables.

⁶ Benefit of primary public education spending per capita for expenditure decile k is calculated as (total public expenditure on prim schooling/total number of public primary school students in population) x (number of primary public school students in decile k/total population in decile k); similarly for benefit of secondary and tertiary spending.

⁷ For example, expenditure on building or upgrading a primary school may lead to an increase in future enrollment in nearby areas – an impact not captured by looking at existing enrollment rates, which is what the static benefit-incidence analysis does.

⁸ Hussain (1999), p. 19, argues more strongly for the pervasive and negative influence of semi-feudal landlords on the Pakistani state.

⁹ http://wb.eiu.com/report_full.asp?valname=CRBPK2&title=Country+Report+Pakistan#7

¹⁰ Talbot (1998), p. 37-38. The government is introducing an agricultural income tax as of this writing (March 2001), but it is too soon to tell how effective it will be at mobilizing revenue from landlords.

¹¹ Gazdar (2000), p.46

¹² Ibid., p.51

¹³ Ibid., p.55

¹⁴ Ibid., p.50

¹⁵ While official figures capture only a fraction of the total inflows, there is no reason to think that the unofficial remittances evolved in a different direction over this period.

¹⁶ Barro (1998) shows that health, education, and fertility indicators significantly affect growth outcomes

¹⁷ See footnote 3 for a discussion of the methodology used in these simulations, with the variable of interest now being governance instead of enrollment. The governance indicator used in the growth regressions is an average of three International Country Risk Guide Indicators – rule of law, bureaucratic quality, and corruption. The time period is 1984–99.