

INTERNATIONAL MONETARY FUND
AND
THE INTERNATIONAL DEVELOPMENT ASSOCIATION

PAKISTAN

Interim Poverty Reduction Strategy Paper—Joint Staff Assessment

Prepared by Staffs of the International Monetary Fund (IMF) and the International
Development Association (IDA)

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Summary

The Pakistan Interim Poverty Reduction Strategy Paper (I-PRSP) has been prepared by the Ministries of Planning and Finance in the Federal Government, in consultation with other ministries and district and provincial governments, civil society organizations and bilateral and multilateral development agencies. The consultations endorsed the importance for the country to embrace development policies accelerating creation of economic opportunities and ensuring more effective, accountable, and equitable use of public resources. The I-PRSP reflects strategy papers prepared by the Government in office since October 1999 and reforms implemented since then. They have all been the subject of public consultation and debate. The I-PRSP is an evolving document which sets out the process underlying a sweeping and ambitious program of reforms—political, economic, institutional—aimed at establishing the foundations of an open, modern and prosperous society. In a few areas, notably governance, devolution, banking sector reforms, the I-PRSP does not fully reflect the scope and depth of reforms already underway; some sector strategies still need more articulation, and some policy slippages are not sufficiently highlighted.

All this notwithstanding, the I-PRSP does convey the thrust, range and complexity of the program in which Pakistan has embarked, and the solid track record it has built in the short period of two years. This document goes much further than the requirements for an I-PRSP, provides a sound basis for a full PRSP as well as a credible rationale for the Fund and the Bank concessional assistance programs. The Paper presents a candid, and analytical assessment of the challenges Pakistan faces: extracting itself from a debt trap, accelerating growth, improving social indicators abnormally low for a country at Pakistan's level of income and restoring the credibility and integrity of public institutions. The policy framework presented in the I-PRSP is a sound one, though a number of areas will require strengthening in a full PRSP. While post-September 11 developments have brought Pakistan new challenges, new opportunities, and new risks, they do not fundamentally alter the country's economic and social priorities and associated stabilization and structural policies reflected in this I-PRSP.

Next steps envisaged for a full PRSP are formulation of provincial PRSPs which the Federal Government expects the Provinces will conduct in consultation with the districts, the costing of poverty alleviation and social programs, and a fuller articulation of strategies in key sectors, especially those where implementation rests with provinces or districts. Particularly important in the PRSP will be: (a) a human development strategy focused on achieving universal primary enrollment in education and effective delivery of basic health services in an environment in which local governments have much greater responsibilities; (b) a strategy to address capacity constraints at the provincial and local governments levels; (c) the formulation by the Provinces of an effective rural development strategy; (d) implementation of monitoring mechanisms for social achievements and the use of public resources, with feedback mechanisms to calibrate policies as needed in light of results; and (e) revisit the ambitious Government social development targets—particularly those related to school enrollment and health status. Accuracy of baseline data and information on education and health are important concerns, expected to be addressed in the next few months. The full PRSP is expected to be completed by the new elected Government that will come to power in October 2002.

I. INTRODUCTION

1. Pakistan's development had a promising start after Independence. Helped by large external resources—Pakistan has been one of the world's largest recipients of official development assistance since 1950—the country was able to grow at slightly over 2 percent per capita, tripling per-capita incomes between 1950 and 1999 and yielding substantial declines in poverty. While this is an achievement compared to many stagnating low income economies, it is much below what other developing countries, such as those in East Asia, were able to achieve, and below Pakistan's potential. More seriously perhaps, pervasive and deep problems of governance, growing public spending on defense and other unproductive programs, and insufficient focus on human development eroded the country's institutions, weakened economic management, and created an increasingly unfavorable investment climate. In the 1990s, these problems were compounded by external shocks and exacerbation of governance problems. Most of the decade was lost in stop and go stabilization-cum-structural reform programs which deteriorated further an investment climate already weakened by a turbulent and uncertain political environment, ambiguous government commitment to free markets and erosion of accountability and integrity in the major institutions of the state.

2. Of particular concern is the fact that Pakistan's social indicators remain below those in countries at similar levels of income. Internal differences in poverty and human development have also persisted over time, or widened—among regions, between rural and urban areas, and between women and men. Pakistan's social indicators, including infant mortality, life expectancy, female primary and secondary enrollment are today among the lowest in the world. A major effort started in the early 1990s to improve public sector social service provision through an 8-year long effort called the Social Action Program (SAP), in part financed by external development agencies, which has so far been unable to achieve its targets on a number of focus areas.

3. The I-PRSP in part represents a consolidation of many strategic exercises by the Government of Pakistan since it came to power two years ago. Well formulated reform strategies for key areas—macroeconomic stabilization, debt management, banking system, tax policy and administration, devolution—provide a sound policy agenda to be implemented in the next three to four years. In some key areas, however, rural and human development in particular, reform strategies need be considerably strengthened.

II. POVERTY DIAGNOSTICS, MONITORING AND ANALYTICAL CHALLENGES

4. **Poverty Diagnostics.** The analysis in the I-PRSP indicates that poverty has remained stagnant in the 1990s. National poverty head-count rate changed from 29.3 percent in 1993–94 to 32.2 percent in 1998–99 according to calculations based on the calorie-based poverty line used by the Federal Bureau of Statistics (FBS), and from 28.6 percent to 32.6 percent over the same period (head-count in 1990–91 was 34 percent) according to calculations based on the basic need-based poverty line used by the World Bank. While urban poverty has fallen, rural poverty has shown little improvement between 1990–91 and 1998–99 according

to either calculation, which implies a widening of the rural-urban gap over the 1990s. This is of particular concern because 71 percent of Pakistanis live in rural areas. The incidence of rural poverty is closely associated with lack of ownership of agricultural land. The poor are also less able to diversify their agricultural production and are thus more susceptible to economic shocks. As in other South Asian countries, large family sizes, low level of educational attainment and outcomes in health constrain the poor's ability to get out of poverty. Gender differences remain substantial in all measurable outcomes, particularly in education and health.

5. Information on poverty, its characteristics, and national and regional trends—come from two main surveys: The Pakistan Integrated Household Survey (PIHS) and the Household Income and Expenditure Survey (HIES), both conducted by the Federal Bureau of Statistics. Five rounds of data from HIES, the primary source for estimates on poverty trends, are available in the 1990s (1990–91, 92–93, 93–94, 96–97, and 98–99, when PIHS and HIES were combined into a single survey). The diagnostics on poverty in the I-PRSP uses such sources to highlight trends in poverty, and its characteristics and correlates. Additional sources of information used are the economic and census survey for Pakistan, the agricultural census, the labor force surveys, specialized education and health information systems, and other internal government sources.

6. The various data sources and definitional differences have often led to conflicting measures on important indicators like poverty measures, gross and net enrollment rates and health indicators. This has resulted in the I-PRSP reflecting several sources as baseline information, which requires careful evaluation. The full PRSP process therefore needs to address this challenge of rationalizing baseline information, and setting targets that are consistent with the adopted data sources and definition, including the setting of a national poverty line that could be updated consistently over time. This exercise of setting base lines and targets is crucial for costing of poverty alleviation programs to ensure consistency between sectoral projections and the fiscal and macroeconomic framework. The World Bank and other donors are already working with Government of Pakistan on this front.

7. **Monitoring.** The I-PRSP develops an elaborate framework for tracking pro-poor public expenditure and poverty monitoring in a coordinated way. A tentative set of indicators has been identified to track progress on important aspects of poverty, and intermediate indicators that can be tracked on a short term basis (the I-PRSP envisages 6 months to annual which is possibly an optimistic target) have been developed that link public expenditures more closely to results (e.g. number of functioning schools). Key poverty alleviation initiatives that are articulated in the I-PRSP will also be carefully monitored, along with progress in the implementation of specific safety net programs (summarized as Annex 1 of the I-PRSP). While the authorities have made a good start in setting up a basic system to track public expenditure and linking it with the monitoring of output and outcome indicators, much work remains to be done for the full PRSP, which is highlighted below:

Expenditure Tracking

- (i) Monitor spending in important sub-sectors and programs like primary education, and excluding programs and sub-sectors that may not be clearly poverty oriented.
- (ii) Track expenditure data by economic classification allowing important disaggregation (like salary versus non salary expenditures.)

Monitoring of Intermediate and Outcome Indicators

- (i) Adopt a national poverty line and consistently update for trends in poverty.
- (ii) Select priority indicators for monitoring poverty outcomes and related intermediate targets. This entails a challenging exercise of setting baselines and targets, employing a consistent definition and an identified data source, and involving the provinces and local governments where most of the service delivery takes place and the information resides.
- (iii) Build technical capacity, particularly in the provinces and districts—an important aspect in implementing effective monitoring.

8. The institutional arrangements for implementation of the monitoring system are an outstanding challenge. The I-PRSP does not adequately elaborate how the implementation will actually take place. The new poverty cell in Ministry of Planning mentioned in the paper is yet to build the requisite capacity to undertake this task.

9. **Analytical Challenges.** The lack of systematic data constrains the analysis of issues like poverty dynamics and vulnerability, rural and urban poverty, that are necessary to design mechanisms for appropriate targeting of poverty reduction programs. There is also a need for analysis informing the possible adverse impacts of some key macro/structural policies on the poor and other socio economic groups. Finally, there is a serious lacuna in the area of assessment of key poverty programs like Kushal Pakistan and Katchi Abadi (housing for the urban poor), which play a central role in the I-PRSP. Donor efforts to support the Government's initiatives to address these analytical gaps, presently ongoing, are summarized below:

- (i) A representative household survey spanning the primary agro climatic zones (conducted jointly by World Bank and Pakistan Institute of Development Economics under the aegis of the Poverty Assessment) is currently underway in Pakistan, with a specific focus on identifying productivity bottlenecks in agriculture, as well as enabling a rich analysis of poverty dynamics and vulnerability thanks to its panel structure. The data will be available for analysis and recommendations before the full PRSP is completed. This survey will also be a useful instrument for tracking changes in important indicators of human development and poverty in the coming years, since it can be fielded repeatedly, in its entirety, or in select provinces, depending on what is needed.

- (ii) The Social Impact Assessment for Pakistan planned to be delivered in calendar year 2003 (jointly prepared by the Fund and the Bank, with Pakistan as one of the pilot countries for this exercise) will serve as a useful starting point for assessing the impact of macro policies on the poor and socially disadvantaged groups. In particular, this study will help to identify the possible adverse consequences of some key policies, currently envisaged in the area of utility and fuel prices for the poor. The actual set of policies to study is still being decided by Government of Pakistan and the Bank and Fund.
- (iii) A serious evaluation of targeted poverty programs and priority social sector expenditure programs (e.g. primary education and basic health) is a key outstanding challenge that will be essential for scaling up these efforts in an informed way.

III. THE POLICY AGENDA

10. At the heart of the Government's strategy in the I-PRSP to reduce poverty is a program of macroeconomic adjustment to foster growth, improve governance, and initiate reforms in key sectors, including human resource development and rural. The government considers that progress is needed on all these four fronts to improve the investment climate in the country, reduce the economy's vulnerability to external or internal shocks, put the economy on a sustainable growth path, and ensure that growth is translated into palpable improvements in living standards for the population at large, and the poor. The I-PRSP acknowledges the fact that these structural reforms will take time to yield results, and that in the next two to three years the Government should focus on maintaining macro balances and improving the efficiency of public investment, hence restoring credibility and creating the basis for private investment in the future. The I-PRSP provides a good synthesis of the policies and institutional changes being implemented in each of these four areas, as well as of the challenges facing implementation. In some areas, however, the government policy agenda is ahead of what is reflected in the I-PRSP in terms of policy goals, and achievements regarding implementation. Some examples are banking reform, the reform of the Central Board of Revenue, and decentralization.

Macroeconomic and Structural Policies

11. **Macroeconomic Stabilization.** Pakistan entered the new century with public debt on an unsustainable path, and external debt indicators worse than most HIPC countries. While there were several attempts at adjustment over the 1990s, repeated policy slippages and reversal of structural measures were responsible for their failure. Poor economic management caused macroeconomic instability and raised external vulnerability that eventually resulted in a full balance of payments crisis in 1998 and critically low reserves.

12. During 2000/01, in the context of a short term Fund supported program, the government re-established credible economic policies that provide a sound basis for the medium term program envisaged in the I-PRSP. The path of fiscal consolidation envisaged in the I-PRSP is appropriately ambitious to curb unfavorable public debt dynamics. This is also

essential to raise national savings in order to finance higher private investment, as the I-PRSP is appropriately cautious on prospects for higher private savings. While public spending is being restructured to favor the poor, the overall levels of health, education, and other poverty related expenditures still remain disturbingly low by international standards. The I-PRSP rightly stresses that these fiscal targets hinge upon the realization of the government's projected revenue increase, which has been the Achilles' heel of past fiscal adjustment experience. However, the macroeconomic framework presented in the I-PRSP is sketchy and a fuller analysis would have pointed to the external adjustment problem and the large size of the financing gaps, and highlighted the modest and insufficient room left for current budget allocations in education, health, and other priority areas. Discussion of the financing constraint would also highlight the need for prioritizing the various poverty reduction programs.

13. Implementation of the Central Board of Revenue (CBR) reform, and measures to broaden the tax base and eliminate tax exemptions are therefore crucial. Against this background, the final PRSP should discuss contingent revenue measures to offset the emergence of possible tax shortfalls. On the expenditure side, the pro-poor orientation of the current Public Sector Development Plan (PSDP) is unclear. In the full PRSP, as well as in the 2002–03 annual budget and PSDP, firmer links between expenditure programs and outcomes will need to be established and provide the information for a pro-poor restructuring of public expenditure. On the monetary front, the I-PRSP rightly emphasizes the need to maintain a prudent monetary policy in order to keep inflation low (thus protecting the poor). A flexible exchange rate will be key to absorb external shocks and stimulate exports.

14. **Growth Prospects.** Consolidation of macroeconomic fundamentals and the wide-range structural reform agenda in the I-PRSP are broadly appropriate to achieve the twin goals of higher growth and faster poverty reduction. While not too ambitious, the growth rate envisaged in the I-PRSP represents a big increment from recent performance. Growth in Pakistan has been well below its potential for a decade as a result of low savings mobilization, poor investment climate, political and economic uncertainty, inefficient public spending, and excessive commercial presence of the public sector in the economy, microeconomic distortions, and poor governance. The I-PRSP rightly outlines a structural reform agenda focused on these issues. The achievement of the Government's growth targets hinges on the timely implementation of the structural agenda in the I-PRSP, and in the acceleration of reforms in some key areas—privatization, irrigation and drainage strategy, energy tariff rationalization, Karachi Electric Supply Company (KESC), civil service reform, tax administration, gas pricing, agriculture support services. Delays in policy implementation will reduce the likelihood of the I-PRSP growth forecast being achieved. Lastly, the staff is concerned about the proposed activist role of the state in financing priority sectors, for example, through the Agricultural Development Bank and the Small Business Finance Corporations.

15. **Governance Reforms and Devolution.** The I-PRSP outlines the ambitious governance reform agenda put in place in the last two years. One key pillar of this agenda is reducing incentives for corruption—to be achieved through privatization, rationalization of

import tariffs, rationalization of taxes, and deregulation in a competitive environment. While pressures for tax concessions are strong, and successive governments in the past have succumbed to these pressures, it is important to recognize that private investment will not be brought back in any significant scale through costly tax privileges and time bound guaranteed return on investments—which on the contrary undermines the quality of the investment climate. The second pillar of the governance reform agenda includes reform of some of the country's fundamental institutions: the Central Bank, the tax authority—Central Board of Revenue, the Police, judicial system, the civil service, the Auditor General and Controller General of Accounts—reforms that some provinces are considering emulating at their level. The third pillar consists of reforms in the public financial management systems and institutions, and implementation of policies to increase transparency and information on government activities to facilitate public oversight. The fourth pillar of the government strategy is establishment of an effective anti-corruption agency to prosecute and deter acts of corruption.

16. The creation of local governments with a considerable degree of autonomy has been one of the major initiatives of the current government. The Government believes implementation of its devolution strategy holds the promise of a “grass-root” transformation of Pakistan's politics, and better citizens’ oversight of government programs. Implementation plans for devolution include ensuring that all local governments have the technical and administrative capacity in their new roles, and are accountable to the people. For example, the central government is providing extensive technical assistance to ensure adequate planning and budgeting systems are in place, and transparently provides information to the public. While it is still too early to assess achievements and shortcomings, in the short period of two years district-level elections have been completed, and new local governments established. The effective working of district level governments and the building of the requisite institutional capacity are likely to be lengthy and challenging processes.

Sectoral Policies

17. **Human Development Strategy.** Failure to develop the country's human resources is perhaps one of the most daunting challenges facing Pakistan. Primary gross enrolment rates in 1998–99 were around 69 percent, well short of the target of 88 percent set by the country's ambitious Social Action Program. There are substantial rural-urban gaps, as well as gender gaps. In health, an infant mortality of 83 percent in 1998–99 compares favorably with 127 in 1991, but lags far behind countries with similar levels of income per capita. Additionally, while both contraception awareness and usage have increased significantly, contraceptive usage remains low at 20 percent. Again, there are substantial gaps between rural and urban regions.

18. The Human Development Strategy in the I-PRSP presents an integrated framework to address the critical bottlenecks in service delivery, especially in health and education—where the most urgent challenges lie. As a roadmap to a full PRSP, it notes the importance of full participation of provinces and districts (and the preparation of provincial PRSPs), and of a

detailed costing exercise, both of which are critical to meet the challenges of human development.

19. The experience of the Social Action Program (SAP) made it clear that dysfunctional governance structures—institutions and incentives—that underpin service delivery were simply unable to transform effectively and productively financial resources into concrete delivery of services. And made it clear that accelerating the development of Pakistan's human resources is as much an issue of increasing the allocation of public resources towards this goal, as that of improving the effectiveness of spending through better governance.

20. The I-PRSP describes the ongoing devolution plan as the major policy reform to improve access to education, health and other public services. Devolution is still underway, and will take time to become effective given the important challenges of addressing capacity constraints especially at the district level and below. Furthermore, its success will likely depend on the extent that it solves fundamental governance problems that have bedeviled earlier efforts to improve service delivery. The institutional changes introduced by devolution could increase the incentives of local government to improve service delivery, using electoral competitions to weaken the systems of patronage that have often dominated in the past. Yet it is clear from both domestic and international experience that devolution is no panacea and takes time given the nature of institutional reforms that are essential.

21. On public-private partnerships—that can potentially help in improving access to and quality of service delivery—the I-PRSP mentions some specific initiatives, e.g. initiation of exam boards in the private sector, and collaboration with private sector institutions for teacher training. However these initiatives fall short of integrating the potential role of the private sector into an education strategy. In that context, the increased role of private schools in Pakistan (observed, though insufficiently studied) may offer opportunities for more efficient use of public resources to improve enrollments and incentives for private participation, for example by providing vouchers to the poor to attend private schools. Such an initiative on a limited scale, namely the Quetta Urban Fellowship Program, has been found to have a positive impact on female enrollments.

22. As gender disparities remain substantial in all social indicators, targeted programs are essential to reduce these gaps. For example, low educational attainment for girls in Pakistan can be ascribed to demand-side constraints, rather than solely to supply constraints. In order to address problems on the demand side, the government would need to build into the strategy potential ways to boost incentives, for instance through targeted subsidies especially for girls. Similar initiatives are necessary in the area of health, and access to productive assets, and will need to be developed in the full PRSP.

23. In the area of health, there is limited progress in preventive health care; only about half of the children in the country were immunized in 1996–97, including only about 40 percent of children belonging to households in the lowest income quintile. In view of such shortcomings, the government's medium term health strategy is rightly focused towards raising public sector health expenditures, concentrating on prevention and control programs,

especially in the area of reproductive health, child health, nutrient deficiencies and communicable and infectious diseases. 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. In several cases among these priority areas, it would be necessary to formulate concrete and detailed programs for expansion and strengthening before expenditure can be increased, starting with specific output goals to be achieved over a defined period of time.

24. Moreover, most government services and programs (as listed above) would have to be extended from facilities and staff at the district headquarters hospital level and below. Accordingly, the I-PRSP rightly recognizes the need to reorganize district health offices to make them community based and locally managed establishments; it will be critical for the full PRSP to address in greater detail the issue of how to develop district health systems, in the framework of the planned exercise in devolution.

25. The I-PRSP also confirms the government's commitment to sustaining and expanding targeted interventions that focus on disadvantaged sections of society, especially in rural areas, namely programs like Lady Health Workers Program and Women Health Project. The preliminary results of an evaluation of the federally funded Lady Health Workers program are promising, and a continued commitment to the program is expected to have significant impact on the health of the poor.

26. To summarize, in the area of human development strategy, there is extensive work to be done with provincial and newly elected district level Governments, which is highlighted in the I-PRSP. Planned provincial PRSPs will go a long way toward strengthening this sectoral strategy in the full PRSP. The targets and goals set in the I-PRSP for primary education (100 percent gross enrollment rate (GER) by 2004) and in the various health indicators seem quite ambitious. The expenditures allocated (as noted by I-PRSP) for education show very modest increase from 1.7 percent of GDP to 1.8 percent, and in health a decline from 0.6 percent of GDP in 1995/96 to 0.5 percent of GDP in 2000/01, which is very low by international standards. While there may be a significant provision of services by the private sector in these areas, the current draft does not provide a concrete role for the private sector. More work would be necessary to rationalize targets, goals, and costing in the full PRSP. In the interim, even if half the desired goals were achieved by 2004 it would be a major achievement.

27. **The Rural Strategy.** The I-PRSP highlights the key role that agricultural growth must play in poverty reduction. However, it does not question whether current priorities are appropriate, nor whether there is sufficient coherence between goals and policies to translate the policy framework and expenditure plans into results on the ground. Given the crucial importance of rejuvenating growth with poverty reduction in the rural sector, there is a strong need to reduce policy distortions and create incentives to improve productivity. The latter entails improving access to land, to credit, to infrastructure, particularly water, and to provide opportunities in the non-farm sector in a coordinated way. Since it is clear that strong inter-

linkages exist among the four main issues shaping the rural economy, these must be considered simultaneously when designing policy.

28. Given the recent experience with drought, a critical focus of the I-PRSP is on expanding water storage, by building new dams. The I-PRSP also emphasizes a more realistic pricing of water and better recovery of user charges, and water conservation and management—particularly to address saline soils and water logging in the Indus Basin irrigation system, which threaten the long-term sustainability of agriculture in Pakistan. The importance of community participation is also recognized. This notwithstanding, there are a number of issues that need to be addressed in the full PRSP, even in the narrower regime of irrigation:

- (i) The strategy focuses on creating additional storage capacity through the dam projects (10 times total expenditure on the irrigation sector in 2000–2001), which is essential for Pakistan, but needs to be embedded in a more holistic water management strategy that analyzes access, distribution, pricing and the institutional aspects that govern efficient water resource management.
- (ii) The strategy gives increased emphasis to investment in on-farm water management (OFWM), recognizing its cost-effectiveness in relation to other alternatives. Unfortunately the main benefit of OFWM investment is still seen as increasing the availability of water rather than its more effective use.

29. **Infrastructure and Energy.** As in rural development, a comprehensive infrastructure strategy will need to evolve for the full PRSP. That strategy would need to address a large number of issues related to the governance of the sector to ensure investment decisions are made in a more open, transparent, and effective manner; and the financing of infrastructure to ensure that people's willingness to pay for infrastructure is translated into concrete assets, adequately maintained over time. Regarding public initiatives in urban slum housing projects, the PRSP would need to develop a clear strategy to address issues related to tenure, land regulation, enforcement of property rights, and housing finance. Community infrastructure, rightly an important I-PRSP priority, would need to evolve planning and policy frameworks in the context of the devolution underway.

30. On energy, the I-PRSP provides a cogent summary of the reform goals the Government has been pursuing in this area, but it may not fully recognize the difficulty of the reforms ahead, particularly in the power sector. In the latter context, the paper does not recognize the fact that tariffs adjustments have been slow in the past, and more importantly that tariff increases must be accompanied by improvements in operational performance. Also, a major problem in the energy sector is the large losses of the Karachi Electricity Supply Corporation (KESC), which may endanger some of the Government's fiscal achievements. Last, while the I-PRSP rightly proposes privatization of distribution and generation as the relevant goals to improve the sector efficiency, it does not acknowledge that privatization will take time, and that in the meanwhile pressing investments will be needed.

IV. PREPARATORY PROCESS

31. The Government undertook a substantial process of consultations through seminars at the district, provincial and national levels during the preparation of the I-PRSP. It intends to continue the PRSP dialogue through further consultations with the provinces to prepare the full PRSP- with the added ambitious goal of provinces also producing provincial PRSPs during this phase. The PRSP dialogue has also made a special effort to consult with staffs at different levels of government and has reached out to NGOs and community-based groups through the seminar series. The I-PRSP has also been placed in the Finance Ministry's website, to engender debate and discussion.

32. Looking ahead, for a full PRSP, the Government's first priority should be to complete consultations with the provinces. With elections scheduled for October 2002, it would thus be desirable to broaden consultations for the full PRSP to include political parties, the private sector, and the media. Since the country is in a process of transition, obtaining buy-in from key political interests is crucial to the sustainability of the reform beyond the elections.

33. The press has evolved into an effective forum of policy debate in Pakistan. The full PRSP process could benefit enormously from systematic use of the public media to build national consensus on the reform agenda. In this respect, there is a need to evolve an effective communication strategy, to ensure continuous support for the reform program.

34. Finally, donors and multilateral organizations have also been consulted for the I-PRSP, have been very supportive to date and are willing to provide comprehensive support in the full PRSP preparation. A wide range of capacity building initiatives are underway or being planned to facilitate the Government with the implementation of the poverty diagnosis and monitoring exercise Asian Development Bank, Department For International Development, United Nation Development Program, and the World Bank.

V. RISKS AND CHALLENGES

35. The I-PRSP outlines an ambitious program of change—in economic policies, in institutions, and in the civil service culture. It underscores that the fundamental challenge for Pakistan is to (a) raise financing (through reallocation of resources and mobilization of additional domestic and foreign resources) that would allow a more ambitious increase—in relative and absolute terms—of the extremely low levels of poverty expenditures; and (b) improve governance and institutional capacity to ensure that additional resources can effectively reach the poor, which the Government has already embarked on through the devolution process that is underway. The risks faced in the implementation of this program are essentially four: political opposition to reform; lack of continuity, insufficient institutional capacity; and exogenous shocks.

36. Of all the risks, political opposition to reform is perhaps the most immediate. The reforms being implemented challenge numerous vested interests. The clearest example was taxpayers' resistance to the registration drive when government efforts to widen the tax net were met with traders' strikes and widespread resistance in 2001. While in the end the

Government did prevail, the magnitude and duration of the reaction highlighted the type of resistance the program could run into—as it challenges vested interests in banking, in state owned enterprises being privatized, in power companies seeking to reduce theft, in banks seeking to reduce poor performance, and in consumers benefiting of subsidized energy prices. A mitigating factor is that the government has been careful of possible popular reactions, and has sequenced reforms accordingly. It has made a deliberate effort to communicate the content and rationale for unpopular measures being taken, and sought to pace the timing of the reforms to minimize adverse impact—for example, gas price increases have been introduced during the summer when consumption is the lowest. That said, delays in implementation remain an important risk, they would hinder the return of confidence, and the attainment of the growth targets envisaged in the I-PRSP.

37. Continuity risk is also important. The current government comes to the end of its term in October 2002, and there is naturally a question whether the next government will continue implementing the program the current government has designed and started implementing. To mitigate this risk the government has sought to make many of the reforms difficult to reverse (e.g. devolution with elected officials now taking charge of the administration in the districts, privatization of banks, reform of the CBR), and to build consensus around what remains to be done. That said, it should be recognized that lack of continuity would threaten many of the benefits expected from the program.

38. The main implementation risk stems from the technical and institutional capacity constraints especially in the reforms that involve governments at the provincial and district levels as well as in the preparation and implementation of the full PRSP. The Government would need to address the issue of resolving where such responsibilities will reside (Ministry of Finance, Planning, or create a PRSP Secretariat) for implementation as well as the monitoring and tracking of programs and policy reforms. During the preparation of the full PRSP, a detailed diagnostic of technical capacity shortcomings will be assessed, and potential responses identified. The government has also given prominence to training of government officials.

39. Last, exogenous shocks may require adjustment in fiscal and external policies beyond what is being envisaged. In particular, growth may turn out to be less than anticipated in the current forecasts underlying the macroeconomic program. Lower growth could be caused by the impact of a longer than expected global slowdown or protracted military operations in Afghanistan on exports, or weather related shocks to agricultural output. These shocks could be, in part, weathered by the floating exchange rate regime but would have also to be met through a combination of additional adjustment measures and external financing—none of which can be taken for granted. If concurrent with excessively timid debt relief, exogenous shocks would also delay the return to external sustainability, which the I-PRSP rightly considers as a key condition to achieve Pakistan's growth and poverty reduction objectives.

40. The I-PRSP is deeply rooted in the economic reform program that was launched by the Government of Pakistan in 1999. The document goes much farther than the standard requirements for an I-PRSP. Moreover, the process underpinning the I-PRSP demonstrates a

strong commitment of the Government to developing a strategy aimed at achieving growth with poverty reduction. The staffs of the World Bank and IMF consider that the I-PRSP provides a sound basis for the development of a fully participatory PRSP, and for Bank and Fund concessional assistance. The staffs recommend that the Executive Directors of the World Bank and the IMF reach the same conclusion.

**Pakistan: Key Bank/Fund Events Related to PRGF/PRSP
December 2001–October 2002**

Institution	Event	Expected Time
World Bank	Board discussion of I-PRSP and Joint Staff Assessment	December 4, 2001
IMF	Board discussion of Three-Year PRGF Arrangement, and of the I-PRSP and Joint Staff Assessment	December 2001
World Bank and IMF	Social Impact Assessment	Beginning Dec. 2001
Government/World Bank	Human Development Forum	January 2002
World Bank	Poverty Assessment	March 2002
IMF	2002 Article IV Consultation and First Review Under the PRGF Arrangement	March 2002
World Bank	Development Policy Review	May 2002
IMF	Second Review Under the PRGF Arrangement	June 2002
World Bank and IMF	Board discussion of PRSP and Joint Staff Assessment	October 2002