

**Pakistan: Poverty Reduction Strategy Paper—Joint Staff Advisory Note**

This paper was prepared based on the information available at the time it was completed on February 19, 2009. The views expressed in this document are those of the staff team and do not necessarily reflect the views of the government of Pakistan or the Executive Board of the IMF.

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

Copies of this report are available to the public from

International Monetary Fund • Publication Services  
700 19th Street, N.W. • Washington, D.C. 20431  
Telephone: (202) 623-7430 • Telefax: (202) 623-7201  
E-mail: [publications@imf.org](mailto:publications@imf.org) • Internet: <http://www.imf.org>

**International Monetary Fund**  
**Washington, D.C.**

THE INTERNATIONAL DEVELOPMENT ASSOCIATION

AND

INTERNATIONAL MONETARY FUND

PAKISTAN

**Joint Staff Advisory Note on the Second Poverty Reduction Strategy Paper**

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

Approved by Isabel Guerrero (IDA)  
Juan Carlos Di Tata and Anthony Boote (IMF)

February 19, 2009

**I. OVERVIEW**

1. **The Government of Pakistan completed its second full Poverty Reduction Strategy Paper (PRSP-II) in December 2008.** In March 2008, a new democratically elected government came into power, which in the fall of 2008 embarked on the finalization of the draft strategy inherited from the previous administration. This Joint Staff Advisory Note (JSAN) provides the advice of the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA) for strengthening the PRSP-II and its implementation.

2. **PRSP-II builds on the first Poverty Reduction Strategy Paper (PRSP-I), which was adopted in December 2003, but is shaped by recent political and economic developments.** PRSP-I provided a broad policy framework outlining the road map for accelerating economic growth and poverty reduction in Pakistan. Its implementation resulted in steady progress in education and health outcomes, and in access to drinking water. The economy grew at about seven percent a year on average during 2003/04–2006/07, and the poverty headcount decreased from 34.5 percent in 2001/02 to 22.3 percent in 2005/06. However, in 2007/08, large external terms of trade shocks—the sharp rise in international commodity prices—in combination with policy inaction and internal political turmoil, led to rapidly growing macroeconomic imbalances. In the absence of adequate remedial policy measures to address these imbalances, economic activity slowed down and inflation rose sharply—hindering progress in poverty reduction, and balance of payments pressures intensified.

3. **Against this background, PRSP-II focuses on regaining macroeconomic stability and the growth momentum of 5–7 percent a year, while protecting the poor and vulnerable—objectives that are supported by the Fund’s Stand-by arrangement and the World Bank’s proposed Poverty Reduction and Economic Support Operation.** To steer Pakistan back on a path of broad-based growth, create jobs, and reduce poverty, a prolonged period of macroeconomic stability, financial discipline and sound policies is required. Government’s strategy aims to create adequate employment opportunities, and to improve income distribution and competitiveness through economic liberalization, deregulation and transparent privatization. To mitigate poverty, it aspires for pro-poor growth, with more emphasis than under the previous strategy on agriculture and manufacturing, as well as on services. It also seeks to strengthen the social safety net to protect the poor and vulnerable. The strategy is consistent with the Millennium Development Goals (MDG).

4. **The strategy consists of nine pillars, ranging from macroeconomic stability and real sector growth to social protection and governance.** In addition, empowering of women and reducing gender disparities is a cross-cutting theme, which is woven through the strategy. While the strategy is comprehensive, identification of core priorities would be helpful given constraints in resource and implementation capacity.

## II. STRENGTHENING LINKS BETWEEN PRSP-II AND DOMESTIC PROCESSES

### A. Consultation Process

5. **The preparation of the PRSP-II has involved consultations at different stages of the process.** Consultations on the strategy started towards the end of 2005, and continued until its launch. In 2005–06, in addition to federal and provincial level workshops, the authorities consulted communities, parliamentarians and civil society; commissioned research studies and poverty and social impact assessments; and constituted technical working groups on various topics. A draft Summary of the PRSP-II was circulated at the Pakistan Development Forum in April 2007 for feedback, and final consultations on the full strategy with different parts of government, civil society, parliamentarians and development partners were conducted in November–December 2008. Owing to parliamentary elections initially scheduled for the fall of 2007, but eventually carried out in February 2008, the completion of the full strategy took longer than expected.

### B. Coordination with Provincial Strategies and Plans and Medium-Term Development Framework

6. **PRSP-II is a strategy of the federal government.** While it refers to provincial initiatives and programs, in particular in the areas of health and education, it is not systematically coordinated with provincial strategies and plans, or the coordination is not

clearly spelled out. Ideally, PRSP-II would reflect both the provincial and federal development strategies, and build on the provincial ones. This would enable the authorities to eliminate any possible overlap and duplication of programs, ensure that federal and provincial programs complement each other, share the key priorities, and exploit synergies. The authorities would be well-advised to develop the PRSP process in this direction.

7. **The Medium-Term Development Framework (MTDF) and the PRSP-II would also benefit from closer coordination.** The Planning Commission of Pakistan launched in 2005 a five-year MTDF for 2005–10, which outlines the federal Public Sector Development Program (PSDP) for the period. However, the framework was neither coordinated with PRSP-I nor properly linked to the budget. Looking forward, since the PRSP-II covers the period up to 2010/11 and the MTDF expires in 2010, the Pakistan authorities would have a unique opportunity to merge the two documents into a single national development strategy linked to the medium-term macroeconomic framework and the annual budget in 2010/11.

### III. STRENGTHENING PRSP-II AND ENHANCING ITS IMPLEMENTATION

#### A. Poverty Diagnostics

8. **PRSP-II provides a good summary of the trends and spatial patterns of poverty.** The poverty diagnostics follows the official methodology defined in PRSP-I: it is conducted based on the official poverty line and a series of household surveys carried out by the Federal Bureau of Statistics. The analysis confirms a significant poverty reduction since 2001/02, and puts it in a historical perspective by showing the longer-term trends since 1987/88. It also rightly points out the limitations of the 2005/06 poverty estimates for assessing the impact of the recent economic crises.

9. **The diagnostics provides rich profiles of the poor by linking the poverty status with various socio-economic indicators and household demographics.** It shows that the educational attainment of the household head, agricultural landholding, and the household size remain key correlates of poverty. Such identification of characteristics of the poor will be useful when designing the targeting of social safety nets. Also, the analysis provides close links between poverty and access to facilities, such as hospitals and schools. In addition, it highlights the need to further improve the access to services, while taking into account service quality.

10. **Additional studies would be useful to guide the implementation of the strategy in some areas.** First, although the diagnostics mentions the importance of access to finance, it lacks empirical evidence supporting this statement. Since there has been substantial expansion in access to finance, the staffs recommend that the authorities undertake a more detailed analysis of its poverty impact. Second, the analysis of gender issues in relation to poverty is limited, notwithstanding that gender mainstreaming remains a cross-cutting theme

of the PRSP-II. Gender breakdowns of school enrollment and health outcomes are included in the document, but their links with poverty are not discussed. Finally, an analysis of the impact of social safety nets on the poor and vulnerable would be welcome.

## **B. Macroeconomic Framework**

11. **PRSP-II provides a broad overview of macroeconomic trends since early 2000.** It rightly points out that the pickup in average real GDP growth to about 7 percent a year during 2002/03–2006/07 is in part explained by heavy reliance on external financing and an expansionary fiscal stance, while tax revenue remained low and national savings stagnated. This development model made Pakistan vulnerable to the external shocks (higher food and oil prices) that buffeted the economy in 2007/08. The paper further explains that against the background of political instability and a deteriorating security situation, the government did not pass through to consumers and producers higher energy and food prices. This led to a significant increase in the budget deficit, which was mainly financed by the State Bank of Pakistan (SBP). The increasing import bill and buoyant domestic demand widened the current account deficit to an unsustainable level (8.4 percent of GDP) at a time when capital inflows declined, in part reflecting the global slowdown, leading to a reduction in international reserves to less than one month of imports by end-October 2008. The paper could have also mentioned that increasingly negative real interest rates accompanying the buoyant domestic demand had contributed to a rise in CPI inflation to 25 percent in October 2008 (compared with 9.3 percent in October 2007) and to sharply widening external imbalances.

12. **The short-term macroeconomic framework is consistent with the key objectives of the Fund-supported program under the Stand-By Arrangement (SBA).** The strategy appropriately targets a significant reduction in inflation and external imbalances through a tightening of macroeconomic policies, in order to lay the foundations for sustainable low-inflation growth.

13. **The key element of the government’s strategy is to reduce the fiscal deficit from 7.4 percent of GDP in 2007/08 to 4.2 percent in 2008/09 and 3.3 percent in 2009/10, with an expanded and effective social safety net to protect the poor and vulnerable groups.** This fiscal adjustment will be achieved through a significant reduction in energy and food subsidies, a better prioritization of development spending, and revenue measures. Given the significant cuts in subsidies and the still high inflation, expenditure on social protection programs is envisaged to increase to 0.9 percent of GDP in 2008/09, from 0.3 percent in 2007/08, and the government is finalizing its preparatory work on scaling up social safety net spending. While a more comprehensive and better-targeted social safety net is being designed and rolled out, the staffs recommend that these additional funds be allocated either to existing programs, such as the Bait-ul-Mal, or launching complementary programs for income-generation, such as skills development, that the government is considering.

14. **While the need for a tight monetary policy is broadly acknowledged, the analysis of monetary and exchange rate policy issues could be strengthened.** In particular, it is important to stress that maintaining a tight monetary policy is critical to protect the country's international reserve position, ensure the targeted placement of treasury bills with commercial banks, and reduce inflation. The importance of improving the liquidity management framework and strengthening SBP independence should also be reflected. The strategy rightly emphasizes the merits of exchange rate flexibility, but could also mention the commitment (under the SBA) to remove restrictions on current transactions, and phase out the SBP allocation of foreign exchange to oil importers which is already taking place.

15. **The feasibility of the medium-term macroeconomic framework crucially depends on the effective implementation of medium-term reform measures.** The strategy focuses on tax policy and administration reforms, a significant improvement in development expenditure management, financial sector reforms, and further efforts to improve competitiveness. The recent economic crisis has highlighted weaknesses in public debt management, which the government is committed to strengthen, and should also be covered in the PRSP-II. A clearly articulated medium-term debt strategy is crucial for sound debt management and the development of an effective government securities market. The finalization of the reform agenda in these areas and its steadfast implementation are essential to achieve the targeted increase in real GDP growth to 7 percent a year by 2012/13, from the projected 3.4 percent in 2008/09, while undergoing a gradual reduction in the current account deficit to 3½ percent of GDP and raising gross official reserves to \$14.5 billion (2.6 months of imports).

16. **The strategy could have usefully analyzed the main risks to the baseline medium-term outlook and elaborated on appropriate policy responses.** The impact of a more prolonged slowdown in trading partner countries' growth, lower remittances from the Gulf Cooperation Council countries, lower FDI, and a delayed resumption of portfolio inflows are key downside risks meriting consideration. At the same time, the recent decline in oil import prices is having a significant positive impact by helping to reduce the external current account deficit. The strategy could have also indicated areas in which additional donor financing should be allocated.

### C. Sectoral Policies

17. **PRSP-II establishes a comprehensive framework to promote Pakistan's economic competitiveness by identifying macroeconomic stability, infrastructure, human resources and strong institutions as the key building blocks; and productivity at the firm level as the key outcome.** A set of policy commitments to implement the framework is listed, including the establishment of a trade competitiveness forum; open product markets and removal of trade related bottlenecks; labor law reform; continuation

of a vigorous privatization program; and elimination of barriers to entry, exit and domestic trade. The strategy also rightly limits direct government interventions to public goods, such as quality systems, knowledge flows, export promotion, and safety nets.

18. **However, there is too much emphasis on steering policies and programs towards specific product groups and firms of specific size—particularly small and medium-sized enterprises (SMEs).** The strategy rightly recognizes the small firm size (about 95 percent of firms in Pakistan are SMEs) as an impediment to Pakistan’s competitiveness, but the proposed policy framework directed at SMEs in the areas of finance, business regulation, land allocation, industrial programs, direct grants for product development, upgrading, training, and marketing, as well as the proposal for an SME Act to legislate a business environment specifically for SMEs should be carefully designed to be cost-effective and efficient to reap the intended growth enhancing benefit. The PRSP-II appropriately seeks a productivity-based export strategy, but proposing to promote specific product groups might introduce distortions. The playing field should be level for all product groups and for firms of all sizes. Therefore, the staffs recommend that the authorities revisit these plans. Specific policy and program actions could be strengthened in areas which are seen as barriers to entry and growth, such as land markets, creditor right enforcement, an improved judiciary and strengthened competition policy.

19. **PRSP-II covers key issues on access, governance and quality of education, taking into account the provincial level educational programs and interventions.** Education expenditures increased steadily during 2002/03–2006/07 and, looking forward, it would be important to retain this trend.

20. **While the strategy focuses on the right priorities in health, the related financing and capacity building requirements need to be assessed and the monitoring framework strengthened.** The programmatic priorities on maternal and neonatal health, family planning, nutrition and the control of communicable infection diseases (including TB, HIV-AIDS, hepatitis and malaria) are appropriate and in line with the country’s epidemiological profile. The main thrust of the strategy is on strengthening the supply of services, but demand side interventions are also planned. Organizational reforms aim at strengthening management of primary health services through expansion of the People’s Primary Health Initiative, improvements in hospital management and governance, strengthening of stewardship functions of the Ministry of Health; and innovations, such as health community financing schemes. However, the cost of enhanced and new programmatic interventions would need to be estimated carefully as they could be considerable. Also, the authorities are encouraged to develop further the indicators and instruments to be used to monitor progress, with indicators preferably disaggregated by expenditure quintiles and by districts/regions, as well as the criteria for evaluating the health financing pilots. The staffs recommend that regular health facility surveys are made part of the monitoring framework.

21. **The staffs welcome the detailed articulation of social protection, especially safety nets for the poor and the vulnerable, as an important pillar of PRSP-II.** While social protection was not a fully developed focus area in PRSP-I, a National Social Protection Strategy was completed in 2007. Since then, the current government has doubled the budget for safety nets by launching the Benazir Income Support Program (BISP), partly in response to high food inflation in 2008. The need to protect the poor and vulnerable is even more urgent given significant fiscal adjustment and the global financial crisis that can be expected to further dampen Pakistan's growth prospects and increase the vulnerability of the population. Recognizing such risks, the government has committed to further increasing the BISP budget. This commitment is an encouraging start. The government also recognizes that the existing targeting of BISP has to be improved to ensure that the intended beneficiaries are served by the program.

22. **Moving forward, the staffs recommend that the government moves decisively toward realizing the vision that is espoused in PRSP-II** to ensure that: (i) BISP targeting is improved; (ii) programs with similar objectives are streamlined; and (iii) income generation opportunities are created to help the poor and vulnerable to graduate from social assistance to better lifetime opportunities. The immediate priority would be to implement an improved targeting system for BISP that is to cover 7 million families in 2009/10. The staffs welcome the government recent decision to adopt an objective and transparent targeting mechanism—a so called poverty scorecard—and have it gradually replace the existing targeting system. However, for this intention to be realized, institutional capacity at all tiers of government would need to be created and strengthened. Streamlining other federal programs, such as Bait-Ul-Maal, and provincial programs, such as the Punjab Food Support Program, which serve similar objectives as BISP, would also be essential. In the medium term, the government would need to (a) move from universal subsidies (such as wheat) to targeted ones; (b) ensure that programs such as stipends for education are aligned to a sound targeting base created through the poverty scorecard; and (c) build a robust program that helps the poor graduate from safety net to income generation.

23. **The proposed way forward to increase energy generation and strengthen infrastructure is broadly appropriate and focuses on the key priorities, but the requisite legal framework and institutional capacity for managing fiscal risks needs to be in place.** In light of Pakistan's current energy crisis, enhancing energy generation and efficiency is urgent. At the same time, the availability of affordable infrastructure (dams, roads, highways, and other transport) is essential for the promotion of private sector activity and competitiveness. The strategy has emphasized the role of Public-Private Partnerships (PPPs) in fulfilling these large investment needs. While PPPs can contribute to creating fiscal space, improving the quality and scope of service delivery, and providing better value for money, realizing these gains hinges crucially on developing a legal and regulatory framework and institutions capable of managing the fiscal risks associated with PPPs. Both the regulatory framework and institutions need to be put in place and should be given priority. PPPs should



be subjected to value for money analysis based on a public sector comparator, and they should not be used to bypass budgetary spending controls (i.e., to move public investment off budget). The PPP-policy framework should give the Ministry of Finance a strong role in approving PPP projects because of its mandate to formulate fiscal policy and evaluate the possible budgetary implications of PPPs. PPPs in the transport sector could have been given more emphasis. The list of roads to be undertaken under PPPs, which is presented in the annex of the strategy, should be useful in guiding PRSP-II implementation in this area. The strategy also rightly identifies the limited access to rural roads as an issue affecting a large part of the population, but recommendations to address this problem are needed. In the view of the staffs, this is an area in which the federal government, in consultation with the provincial and local governments, would be well-advised to look into.

#### D. Governance

24. **PRSP-II recognizes the importance of good governance for development and poverty reduction, but proposes a limited reform agenda to strengthen it in Pakistan.** The strategy does not analyze the successes and failures on governance during the PRSP-I period to define priorities for the way forward. Some analysis of the implementation experience of decentralization, for example, would be useful in this regard. The strategy appropriately explains why public financial management, civil service reform, tax administration, and judicial and public procurement reform are all good things to pursue, but in some cases—for example, in the case of public procurement and judicial and civil service reform—little is said about what is proposed for the coming years and how this will be attained. The authorities would be encouraged to focus on these issues and strengthen this part of the strategy. In addition to tax administration and public debt management, there is a need to substantially strengthen public expenditure management (at all levels of government) to enable better budget execution, monitoring and evaluation. Efforts should include introducing systematic and credible commitment control systems, and improving fiscal reporting. Ongoing efforts—including strengthening the government’s cash management—could also be highlighted in the report. Staff recommend that PRSP-II specify an action plan with detailed timetable to guide efforts in this area.

#### E. Costing, Budget, Financing and Targets

25. **The strategy emphasizes that PRSP-II implementation will be prioritized through the medium-term expenditure framework (MTEF), which is updated annually in the context of the budget process.** Sectoral expenditures will need to be embedded in the MTEF, which in turn should be consistent with the medium-term macroeconomic framework. This will ensure that expenditures reflect the policy priorities of PRSP-II, and that the cost of PRSP-II implementation is consistent with the available resources and the maintenance of macroeconomic stability. PRSP-II does not include costing for the entire strategy, but only for three sectors—education, health, water and sanitation—and, within

these sectors, only for the Millennium Development Goal (MDG)-related expenditures. The strategy also provides detailed year-by-year comparisons of projected PRSP expenditures and MDG costing estimates linked to explicit quantitative MDG targets for education, health and water and sanitation; and stresses the limitations of the costing exercise in view of the strong assumptions used to derive the cost estimates and large standard errors owing to the evolving economic and fiscal environment.

26. **While PRSP-related expenditures on education, health and water and sanitation are projected to increase from 2.9 percent of GDP in 2007/08 to 3.2 percent of GDP in 2010/11, Pakistan plans to spend on these sectors less than what the MDG costing estimates would call for during the PRSP-II period.** It would be important to clarify whether and how the resource gap will be bridged during 2008/09–2010/11, especially since it is unclear whether the MDG costing estimates derived in 2005/06 are still accurate for the PRSP-II period. For example, in 2006/07 the net primary enrolment rate in Pakistan was only 56 percent against the MDG target of 100 percent by 2015. Clearly, to meet the MDG target, will require substantial public and private resources. Over the longer term, however, spending on education and health is projected to increase substantially as a percent of GDP, while spending on water and sanitation is not projected to increase.

27. **In light of Pakistan’s deteriorated fiscal and economic outlook, it would be important to bring the MDG and poverty reduction agenda in line with the available fiscal envelope.** Currently, the MDG costing estimates are not aligned with the needed fiscal rationalization. Given the limited fiscal space, unless the targets are adjusted, any resource gap would need to be filled by mobilizing additional donor and private resources. However, for example, in the case of education Pakistan’s recent experience suggests that the public sector has to be the main provider in rural areas and for poor households, where the enrollment gaps are the largest. Hence, moving forward, the staffs would urge the authorities not only to take measures to increase the efficiency of public spending, but also to revisit the allocation of funds across sectors with the aim of re-allocating spending to priority areas.

## **F. Indicators and Monitoring**

28. **Significant progress in data collection has been made since PRSP-I.** This includes the implementation of multi-rounds of the Pakistan Social-economic Living Standard Measurement (PSLM) survey, which was launched in 2004/05 and has been fielded annually since then. The PSLM survey data will help monitor PRSP-I and PRSP-II outcomes both at the national, provincial, and district levels. The latter is particularly useful for enhancing the district governments’ capability of implementing evidence-based policy making. Also, implementation of other surveys, such as the Pakistan Demographic Survey (PDS), has made the monitoring and evaluation (M&E) system in Pakistan more comprehensive.

29. **PRSP-II identifies weaknesses in the existing M&E system and proposes a reform plan to address them.** The staffs share the view that improving data compilation in the Management Information System (MIS), creating poverty related indicators at the district level, and enhancing the quality and timeliness of data are critical for strengthening M&E. Also, as PRSP-II reports, it would be useful to clarify the mechanisms through which the M&E findings will provide timely feedback into the policy process.

30. **As PRSP-II reports, the new Statistical Law will be key for implementing the M&E system and the institutional arrangements.** The new Statistical Law aims to strengthen autonomy and functioning of the national statistical system and proposes a new statistical agency, the Pakistan Bureau of Statistics (PBS), which integrates several existing agencies (Federal Bureau of Statistics, Agriculture Census Organization, Population Census Organization, and the Technical Wing). The strategy could have highlighted how autonomy will be strengthened and explained that the proposed law will also establish a legal framework for PBS, specifying governance processes and an organizational plan for the senior management. Once the Statistical Law is approved, it would be useful for the PRSP Secretariat to hold close consultations with the new agency on the institutional arrangements of the M&E system.

31. **There is an urgent need for strengthening the technical capacity of poverty measurement and review the institutional arrangements.** While the government has given the Center for Research on Poverty Reduction and Income Distribution the institutional responsibility to estimate official poverty headcount rates, delivery has been slow at times. For example, the poverty estimates for 2005/06 were published only in 2008. Such a lag lessens the information value of the estimates for policy makers. Also, the recent erosion of analytical capacity in CRPRID is a concern. It would be critical to review the current institutional framework for poverty measurement and rebuild an effective and reliable poverty monitoring instrument.

#### IV. CONCLUSIONS AND ISSUES FOR DISCUSSION

32. **PRSP-II provides a comprehensive framework for Pakistan's efforts to stabilize the economy and bring it back to a higher growth path.** In the view of the staffs, the main priority areas for strengthening the strategy and its implementation are as follows: (i) develop a detailed tax policy and tax administration reform action plan to ensure that the ambitious revenue mobilization targets are met; (ii) conduct further work on costing the proposed programs and measures, including on health, and, if necessary, revise the targets in light of the fiscal constraints; (iii) implement the envisaged social safety net reform agenda, while streamlining social protection programs with similar objectives; (iv) further develop the reform agenda on governance and public financial management, including on public debt management; (v) establish the appropriate legal framework for PPPs and develop institutional capacity to manage the financial risks associated with PPP financed

infrastructure investment; (vi) lessen the emphasis on directed programs at SMEs and focus the efforts on strengthening the overall investment climate; and (vii) strengthen the technical capacity for poverty measurement and analysis.

33. **Implementation of PRSP-II faces several risks that need to be managed.** These include (i) a further deterioration in the world economy and international financial markets, which could complicate the stabilization efforts by weakening Pakistan's export prospects, lowering capital inflows, limiting economic growth and reducing flexibility for economic reforms; (ii) a deterioration in the security situation, which could shift the government's focus away from economic matters; and (iii) delays in the implementation of reforms because of institutional capacity constraints.

34. Do the Executive Directors concur with the priority action identified by the staffs?  
Do they agree with the recommendations made by the staffs?