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Fiscal Space for Social Protection in Pakistan

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Executive Summary

Social protection has received a great deal of attention and interest in Pakistan since the launch of the Benazir Income Support Programme (BISP) in 2008. In 2012-13, the government's expenditure on social assistance, a component of social protection, amounted to Rs180 billion or 0.8% of Pakistan's gross domestic product (GDP). This included cash transfers, food subsidies, social and welfare services, and expenditure related to natural disasters and public works programs. Expenditure on social assistance programs in Pakistan is considerably lower than the median spending on safety assistance in developing and transition countries.

With fiscal deficit at 8% of GDP in 2012-13, expanding the social protection program has the potential of further compounding the financial difficulties of the government. This paper maintains that although reducing the fiscal deficit is important – not least because the recourse to money printing continues to erode the real value of income transfers to the poor – the answer does not lie in expenditure cuts or freezing of expenditure on social protection programs. It is argued that fiscal space for social protection can and should be created through other options, including reform of energy prices, reduction in the losses of public sector enterprises, improvement of economic governance to restore economic growth to its historical levels, increase in the tax-to-GDP ratio, and public-private partnership.

Reforming Energy Prices

In 2012, electricity consumers with a monthly consumption of less than 700 units received a subsidy of Rs180 billion but the subsidy to lifeline consumers whose consumption was below 50 units was only Rs4 billion. The implicit subsidy provided to compressed natural gas (CNG) consumers in 2010-11 was Rs127 billion. Similarly, households that consumed 3.55 mcft per month received an implicit subsidy of Rs7000 per month. The per-unit implicit subsidy declined at higher levels of consumption but was retained even at the highest tariff slab. In short, very large explicit and implicit subsidies are provided in the energy sector, which are by no means targeted at the very poor. Tariff rationalization is one of the avenues to consider for the government among cost cutting options. The axe need not necessarily fall on the social assistance programs.

Reducing Losses of Public Sector Enterprises and Improving Governance

Resources for social protection can also be made available through cost cutting and better governance in the public sector. An analysis of the full range of such economies is outside the scope of this work but the magnitude of the losses in the public sector enterprises provides an idea of the efficiency gains possible and the extent of resources that can be harnessed. The losses of Pakistan Steel, Pakistan Railways and Pakistan International Airlines together amounted to over Rs87 billion in 2013. Loss-incurring distribution companies in the power sector comprise another major recipient of subsidies. The inability of the distribution companies to collect their utility bills is recorded initially as an amount receivable but some of these dues eventually have to be written off by the government. Build-up of the amount receivable is one of the important causes of circular debt, which amounted to Rs872 billion or 4% of GDP in 2012. Addressing governance issues in public sector companies, and public sector institutions in general, will reduce losses and improve efficiency and allow channelling of public sector funds to resource-starved social infrastructure, including social protection programs.

Economic Growth and Fiscal Space

Between 2007-08 and 2012-13, the economic growth rate averaged 3.2%, compared with the historical average, from 1970 onwards, of about 5%, and an average of 7.2% in the previous four years (2004-2007). A one-percent increase in economic growth adds about Rs200 billion to the GDP (in 2013 prices), and at the tax-to-GDP ratio of about 10% (in 2013), this means additional tax revenue of about Rs20 billion. If the economy had maintained a modest growth of 5% between 2008 and 2013, instead of 3.2%, it would have meant Rs36 billion in additional tax revenues annually over the last four years.

One of the consequences of slow growth is that it reduces the space for social protection. Weak governance and poor economic management are among the reasons for the slow growth rate but exogenous factors and shocks, such as floods, insurgency and energy price escalation, should not be underestimated. The economy remains vulnerable to weather-related shocks and the post-2014 security environment also remains uncertain.

Nevertheless, a number of macroeconomic problems can be traced to the escalation in oil prices since 2008 and the inability of the government to reform the energy sector. If governance reforms in the energy sector are undertaken, if electricity prices are allowed to reflect the higher cost of production, and if revenue collection from consumers of electricity is strengthened, the problem of fiscal deficit and many of the related macroeconomic problems can be addressed. This can also spur economic growth in the short run. Long-term competitiveness and economic growth will require the harnessing of cheaper sources of energy and power generation.

New Tax Measures

Increasing the tax effort can also create the fiscal space for social protection. Pakistan has one of the lowest tax-to-GDP ratios in the world. In 2013, this ratio was 9.8%. The effort by the government to introduce value-added tax (VAT) under the Pakistan People's Party (PPP)-led coalition government (2008-2013), which would have raised the tax-to-GDP ratio to 13-14%, was scuttled by opposition parties and some of the coalition partners of the government. Income tax, the second major source of tax revenue for the federal government after the general sales tax (GST), suffers from exemptions, concessions and evasion, which undermine the presumed progressivity of the tax.

At present, the federal government is collecting sales tax on goods and the provinces are collecting, either directly or through the federal government, sales tax on services. Collection of sales tax as well as income tax is far below potential. Most of the provincial governments have started to raise considerable tax revenue from sales tax on services. Provincial governments also have two other sources of tax revenue, namely agricultural income tax and urban immovable property tax, but these are poorly tapped. Tax on agricultural income, which in effect is a per-acre land tax, raised less than Rs1 billion in 2013 compared with the actual potential of about Rs50 billion if agricultural income was taxed at rates applicable to similar incomes in other sectors of the economy Similarly, tax collection from urban immovable property tax was Rs7.7 billion in 2013 or 0.034% of GDP. This ratio is 0.5 percent in countries with a similar level of development. New tax measures at the federal and provincial levels will not burden taxpayers any more than in comparable countries. At present, the poor bear a heavy burden of inflation taxation. This form of taxation needs to be replaced by taxes that are more equitable.

Public-Private Partnership

If greater private investment is encouraged in areas that are traditionally dominated by the public sector, it will allow greater budgetary resources to be diverted to social protection. The private sector in Pakistan is very vibrant and there are several successful examples of public-private partnership. For a government that is seriously resource-constrained, further opportunities for such partnership should be explored. The substitution of public investment by private investment and of public sector delivery of social services by private sector delivery can create greater fiscal space for the government to enlarge the scope of social protection in the country.

Fiscal Space for Social Protection in Pakistan

Anjum Nasim*

1. Introduction

The last five years have seen a rapid escalation in the social assistance program in Pakistan, with the main safety net program, Benazir Income Support Programme (BISP), expanding its reach to 4.7 million households in 2012-2013.[1] The BISP-led safety net program has attracted great deal of interest.[2] It was launched in 2008 in order to protect the poor from the effects of high rates of inflation. The program is in the process of launching a number of other initiatives, such as conditional cash grant programs and health insurance programs. An independent evaluation of the program is currently under way.[3]

Total expenditure on social assistance programs was Rs179 billion in 2012-13 or about 0.8% of gross domestic product (GDP). Of this, the share of cash transfers, food subsidies and provincial programs on social welfare and low cost housing was 56%, and the remaining 44% was incurred on relief measures against disasters and natural calamities, and on workfare programs. The expenditure is low relative to the average of developing countries.[4] However, with fiscal deficit

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[1] Government of Pakistan, *Annual Plan 2013-14,* Planning and Development Commission of Pakistan, Islamabad, 2014.
[2] BISP is criticized for being politically non-neutral, especially because of the name association of the program with the former leader of the Pakistan People's Party (PPP); inadequate in terms of raising incomes above the poverty line; and for being a permanent fiscal drain on the budget because it does not create conditions for the poor to transition out of poverty.
[3] BISP was quite ad hoc in the way it identified the poor at the outset, but since 2010 it has relied on a poverty scorecard ranking based on a baseline survey conducted in 2008-10 to target the poorest households. However, there is considerable income/asset variability even in the short run which can drive households above or below the poverty score identified for BISP cash grant eligibility. Unless the poverty scorecard is revised at short intervals, which is itself a very expensive undertaking, the BISP beneficiaries may not necessarily be the poorest households.
[4] World Bank, 'Levels and patterns of safety net spending in developing and transition countries', *Safety Net Primer*, issue 30, 2009. From data compiled from individual World Bank country reports and covering 87 developing and transition countries during 1996–2006, the paper shows that 'mean spending on safety nets is 1.9 percent of GDP and median spending is 1.4 percent of GDP across developing and transition countries. For about half of these countries, spending falls between 1 and 2 percent of GDP. Some variation is apparent. Bosnia and Herzegovina, Pakistan, and Tajikistan, for example, spend considerably less than 1 percent of GDP, while spending

running at 8.0% of GDP in 2012-13,[5] the proportion of GDP expenditure on social assistance, already low compared to 2007-08, may be curtailed even further in coming years.

The fiscal deficit will have to be addressed through expenditure cuts or tax measures to contain the rising national debt and address the high rates of inflation experienced over the last five years. There has been considerable reliance on money printing to finance fiscal deficit, and this was possibly an important cause of the high rates of inflation experienced during this period. Between July 2008 and June 2013, inflation eroded the real value of incomes, including the value of cash transfers to the poor under BISP, by about 38%. Addressing the fiscal deficit is therefore important not only for macroeconomic stability and growth but also to protect the real incomes of the poor.

This paper argues that there are many ways in which the fiscal deficit can be curtailed without reducing expenditure on social safety nets. Current subsidies were Rs358 billion in 2013, or 7.4% of total expenditures, and constituted 19.5% of the total government fiscal deficit of Rs1,834 billion.[6] It is argued that it is not just the poor who are subsidized, but also the non-poor who receive substantial explicit and implicit subsidies. Therefore, the cutting down on subsidies should begin with the subsidies provided to the non-poor. The losses of some of the large public sector enterprises (PSEs) are discussed to make the case that better governance is another way to reduce the deficit and find resources for the poor. The draining effect of low economic growth between 2008 and 2013 on tax revenues is explored, and it is argued that better economic governance to restore growth to its historical level can raise substantial additional resources. Some estimates are provided of potential revenues that could accrue if the federal and provincial governments were to tap their tax bases, particularly the value-added tax (VAT) and agricultural income tax. Finally, possibilities of public-private partnership are explored as a way of releasing pressure on the public sector expenditures.

We begin by providing an overview of social protection and pro-poor programs in Pakistan before a detailed discussion of fiscal space aspects.

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on social safety nets in Ethiopia and Malawi is nearly 4.5 percent of GDP because international aid is counted, but would be more like 0.5 percent if only domestically financed spending were counted. Other high-spending countries – Mauritius, South Africa, and the Slovak Republic – finance their safety nets domestically. Spending on safety nets is less variable than spending on social protection or the social sectors.'

[5] State Bank of Pakistan, *Annual Report 2012-13,* Karachi, 2013.

[6] Government of Pakistan, *Fiscal Policy Statement 2013-14,* Ministry of Finance, Islamabad, 2014.

2. Social Protection in Pakistan

Social protection is defined in the National Social Protection Strategy (NSPS) as: '...a set of policies and programme interventions that address poverty and vulnerability by contributing to raising the incomes of poor households, controlling the variance of income of all households, and ensuring equitable access to basic services. Social safety nets, social insurance (including pensions), community programmes (social funds), and labour market interventions form part of social protection.'[7]

Social protection is a right enshrined in the Constitution of Pakistan.[8] The constitutional articles which provide rights-based justification for provision of education, health and social protection (Articles 37 and 38) are in the 'Principles and Policy' section of the constitution and the 'rights mentioned here are subject to availability of money'.[9]

Strong economic growth from 2004 to 2006 created the fiscal space for the government to adopt the National Social Protection Strategy in 2007. It was not until 2008, and particularly after the new elected federal and provincial governments were in place, that fiscal allocations for social assistance increased dramatically. The scale of the programs was far more ambitious than that envisaged in NSPS.[10] By the time the federal government's BISP program and the Punjab government's food support program were launched, the case for social protection had shifted from the way it was advocated in NSPS – economic growth had created the necessary fiscal space – to social assistance in an economic crisis to protect the poor and vulnerable from the consequences of high inflation.[11]

This paper uses a number of related terms, such as *social protection*, *social security*, *social insurance*, *social safety nets* and *social assistance*, the meaning of which should be clearly understood at the outset. The terms *social safety net* and *social assistance* are used interchangeably and in the sense that they are used by the World Bank: 'Safety net/social assistance programs deliver transfers and or services to the chronic poor and those who fall into poverty as a result of a shock. In this sense, they allow individuals to cope with poverty ex-post (after a shock has occurred). Cash transfer programs, feeding programs, employment programs,

[7] Government of Pakistan, *A Social Protection Strategy to Reach the Poor and the Vulnerable,* Centre for Poverty Reduction and Social Policy Development, Planning Commission, Islamabad, 2007, p. 14.

[8] Article 38(d) of the Constitution reads: 'the State shall provide basic necessities of life, such as food, clothing, housing, education and medical relief, for all such citizens, irrespective of sex, caste, creed or race, as are permanently or temporarily unable to earn their livelihood on account of infirmity, sickness or unemployment.'

[9] Institute of Development Studies, *Social Protection Strategy for Pakistan,* Department for International Development, Programme of Advisory Support Services for Rural Livelihoods, Planning Commission of Pakistan, 2006, p. 20.

[10] H. Gazdar, 'Social protection in Pakistan: in the midst of a paradigm shift?' *Economic and Political Weekly,*Vol. 46, issue 28, 2011, p. 6.

[11] F. Bari & A. Cheema, *Political Economy Analysis: Social Protection and Benazir Income Support Programme,* Department for International Development (DFID), 2012, p. 3; Government of Pakistan, *Poverty Reduction Strategy Paper (PRSP) – II,* Finance Division, Islamabad, 2009, p. 66.

e.g., workfare, or social welfare and care services (care of disabled and elderly) are examples of safety nets programs.'[12]

Social security and *social insurance* are also used synonymously, although social security is a broader term and includes employment protection legislation. Again, the World Bank's definitions apply: 'Social security programs provide insurance against particular shocks or events by pooling risks across program participants. These programs allow individuals to mitigate risk (ex ante) and avoid falling into poverty. Safety net programs are financed by general revenues, while social security programs are financed by contributions paid by participants themselves or by the government/others on their behalf. Pensions, health insurance or unemployment insurance are examples of social security/insurance programs.'[13]

The term *social protection* embraces both *social assistance* and *social security*.

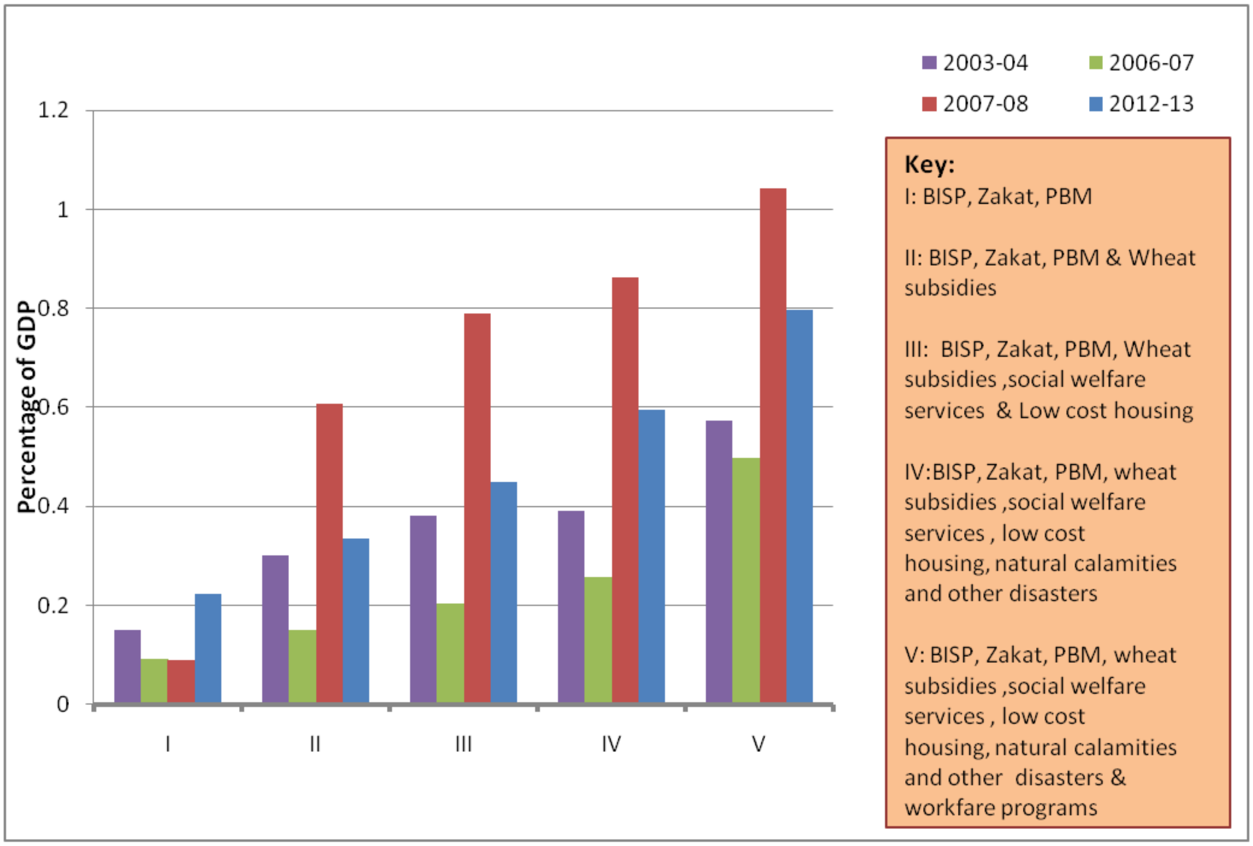
2.1 Social Assistance/Social Safety Net Programs

The main social assistance programs in Pakistan before 2008 included Zakat, Pakistan Bait-ul-Mal (PBM) and some provincially financed programs carried out by the provincial social welfare departments.[14] These programs were relatively small, constituting 0.17% of the GDP in 2007.[15]

In 2008, the Benazir Income Support Programme was launched as an unconditional cash grant program of Rs1000 per month for eligible households. It has dwarfed other social safety net programs. Expenditure on BISP was 0.196% of GDP in 2012-13 with Zakat and PBM contributing 0.026% of GDP. If food subsidies and the subsidy on the Utility Stores Corporation are added to BISP, Zakat and PBM, the expenditure on social safety net programs comes to 0.34% of GDP. Expenditure on social and welfare services and on low-cost housing raises the share to 0.45% of GDP. Other expenditures that can be considered social assistance are flood and disaster relief expenditures (0.145% of GDP) and workfare programs (0.2% of GDP). All of these expenditures taken together raise the total expenditure on social assistance to about Rs180 billion or 0.8% of GDP in 2012-13. Figure 1 provides the share of social assistance expenditures as a percentage of GDP for selected years since 2003-04.

[12] World Bank, *Social Protection in Pakistan: Managing Household Risks and Vulnerability*, South Asian Region, Human Development Unit, 2007, p. 4.
[13] ibid.
[14] Institute of Development Studies, op. cit.; Gazdar, op. cit.; Bari & Cheema, op. cit.
[15] This included disbursements under Zakat, PBM, Workers Welfare Fund (WWF) and Employees Old Age Benefit Institution (EOBI) (Government of Pakistan, *PRSP-II*).

Figure 1: Share of Social Assistance Expenditure (% of GDP) for selected years



Source: Government of Pakistan. *Annual Plan 2013-14*; Government of Punjab. *Annual Budget Statement 2013-14*. Finance Division, Lahore, 2014; Government of Sindh. *Volume-III (Current Expenditure) 2013-14, SC21004-Subsidies*, < http://fdsindh.gov.pk/site/userfiles/VOLUME-III-2013-14/DEMAND-44.SUBSIDIES.pdf> Finance Department, Karachi, 2014; Government of Khyber Pakhtunkhwa. *White Paper 2013-14*. Finance Department, Peshawar, 2014; Government of Pakistan, *PRSP-II*;
Government of Pakistan. *Revised PRSP Budgetary Expenditures for FY 2011-12 and FY 2012-13*, <http://www.finance.gov.pk/poverty/PRSP_Expenditure_201112_2012_13_pro_revised.pdf>. Ministry of Finance, Islamabad, 27 Jan. 2014; Government of Pakistan, *Budget in Brief 2013-2014*, Ministry of Finance, Islamabad, 2014; Government of Pakistan, *Pakistan Economic Survey 2013-14*, Ministry of Finance, Islamabad, 2014; Author's calculations

BISP was approved in the federal budget in June 2008 for the fiscal year 2008-09. The consumer price index has increased from 112 in July 2008 to 179.9 in June 2013. If the real value of the cash transfers in July 2013 were to be maintained at the July 2008 level, the nominal value of cash transfers would need to increase from Rs1,000 to about Rs1,600 per household per month. After winning the election in May 2013, the PML-N-led government increased the monthly cash transfer from Rs1,000 to Rs1,200 per month in its first budget, raising the total cash transfer allocation from Rs40 billion[16] in 2012-13 to Rs75 billion in 2013-14.

[16] The budgeted allocation was Rs70 billion.

BISP is an unconditional cash grant program but conditional cash grant programs, conditioned on school enrolment (Waseela-a-Taleem) and on skill acquisition (Waseela-a-Rozgar) are also in the offing. A skills training program has also been launched in Punjab under the Punjab Employment Opportunities Program (PEOP). The aim of the program is to reduce poverty in some of the poorest districts of Punjab by making workers more employable through training that provides them marketable skills. The trainees are provided a stipend (Rs1,000/month for training within the district and Rs3,000/month for training outside). BISP offers a considerably higher stipend under its comparable program, Waseela-a-Rozgar.

The programs are still in the early stages of implementation and it will be some years before their success can be evaluated. Many challenges exist concerning coordination between the federal and provincial governments; these will have to be resolved for the BISP conditional cash grant programs to succeed.

2.2 Social Insurance/Social Security Programs

The main social insurance program in Pakistan is the old age pension program for civil servants and military personnel. In 2012-13, total pension payments (federal and provincial) were Rs291 billion, which was 1.27% of GDP.[17] Although pension programs are not necessarily targeted at the poor, they prevent vulnerable households from falling into poverty on retirement and in old age.[18] Expenditures on public pension programs are not listed in official Government of Pakistan documents as part of social protection expenditures.[19]

A much smaller contributory pension program also exists for workers in the formal private sector. Employees of industrial, commercial and other organizations in the private sector with ten or more employees are provided a subsistence old age pension cover through a fund managed by

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[17] World Bank (*Social Protection in Pakistan*, p. v) reports the number of civil and military pension beneficiaries in 2003-04 to be 1.9 million of which 1.1 million were military pensioners. Information on the number of retirees is sporadic. The number of military pensioners in 2007-08 was 1.135 million (Pakistan Post, 'Military pension payments', *Pakistan Post*, <http://www.pakpost.gov.pk/financial/pmp.html>, 2008). We estimate the number of pensioners in 2011-12 to be 2.1 million based on the number of active and retired civil and military personnel in 2003-04 and projections till 2011-12.

[18] Pension programs (public or private) would underestimate insurance against age-related shocks because individuals provide for such contingencies through savings and accumulation of assets. 'Pensions are financed directly from the budget in the same way as salaries, and can indeed be seen as deferred payment' (World Bank, *Social Protection in Pakistan*, p. 70). If the compensation package of workers (civil servants) was not broken down into salaries and pensions and they were fully compensated in the present with no pension plan, then workers would plan for the post-retirement period by greater savings and accumulation of assets. If the government were to take this route of payment of compensation for civil servants, public expenditure on social security would drop to zero but the actual expenditure on social security (in the form of greater private savings and asset accumulation) might not change. The inclusion of expenditures on pensions and social security programs as part of social protection programs could thus be misleading.

[19] Government of Pakistan, *Pakistan Economic Survey 2011-12*, Ministry of Finance, Islamabad, 2012.
The *Pakistan Economic Survey* provides a list of social protection programs, which consists of the following: (1) BISP, (2) Microfinance, (3) Pakistan Bait-ul-Mal, (4) People's Works Program, (5) People's Rozgar Scheme, (6) Subsidy on wheat, sugar and fertilizer, (7) Utility Stores, (8) Zakat and Ushr, (9) Child Labour and Children in Bondage, (10) Employees Old Age Benefit Scheme, (11) Social Health Insurance, (12) Workers' Welfare Fund.

the Employees Old Age Benefit Institution (EOBI). In July-December 2012-13, EOBI paid Rs6.6 billion to 0.373 million beneficiaries; the plan was to benefit 0.103 million more people from EOBI by June 2013.[20]

Provincial Employees Social Security Institutions (ESSIs) manage social security schemes for workers in industrial and commercial establishments with ten or more workers and with incomes below a certain threshold. These schemes provide a range of health services and cash benefits, eg sickness benefit, maternity benefit, *iddat* benefit (for widows), death grants, injury benefit, disablement gratuity, disablement pension, rehabilitation benefit, etc.[21] Employers' contributions, equal to 7% of the wages of workers with income below a certain threshold, comprise the main source of revenue for ESSIs. A study published in 2008 by the Pakistan Institute of Development Economics (PIDE) reported that the scheme covered one million workers in about 41,500 establishments.[22]

Another social security program is the Workers Welfare Fund (WWF) for workers in industrial establishments in the private sector with annual earnings above Rs 0.5 million. The contribution to the fund is entirely by employers and is levied at the rate of 2% of the taxable income of the enterprise when it exceeds Rs0.5 million in an accounting year.[23] The fund provides welfare services, such as housing, schools and health facilities, sewing machines for workers, tricycles for disabled workers, and grants for education and marriage. In 2012-13 (July-March), an amount of Rs1.73 billion was paid under WWF to 29,353 beneficiaries.[24]

Social security is also provided by Fauji Foundation to ex-servicemen and their dependents. The Foundation was started from a fund established for war veterans who served the British Crown in World War II. Pakistan received its share of the fund, amounting to Rs18.2 million, in 1947 and it was transferred to the Army in 1954. Instead of distributing the fund among war veterans, a charitable trust by the name of Fauji Foundation was set up and the fund was entrusted to it. The Foundation used the fund to set up a textile mill. From these beginnings, the Fauji Foundation

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[20] Government of Pakistan, *Pakistan Economic Survey 2012-13*, Ministry of Finance, Islamabad, 2013.
'The Employees' Old Age Benefit Institution (EOBI) established under EOB Act 1976, maintains the Employees' Old Age Benefits Fund. It provides old age benefits to insured persons employed in industrial, commercial and other organizations in the private sector. The sources of revenue for the fund are the contributions and any other payments made by the employers, income from investment of the money of the institution and donations. An insured person with 15 years of contribution is entitled to a monthly old-age pension – over 60 years for men and over 55 years of age for women. The Act currently applies to establishments employing 10 or more workers' (Government of Pakistan, *PRSP-II*, p. 72).

[21] J. Haroon, *Profile of Social Protection in Pakistan: An Appraisal of Empirical Literature,* Social Policy and Development Centre (SPDC), Karachi, 2010.

[22] N. Mahmood & Z.M. Nasir, *Pension and Social Security Schemes in Pakistan: Some Policy Options*, PIDE Working Paper No. 42, Pakistan Institute of Development Economics, Islamabad, 2008. The study does not mention the year to which the data pertains.

[23] Workers Welfare Fund, 'Source of income', *Ministry of Overseas Pakistanis and Human Resource Development*, <http://www.wwf.gov.pk/gop/index.php?q=aHR0cDovLzE5Mi4xNjguNzAuMTM2L3d3ZndlYi9mcm1EZXRhaWxzLmFzcHg%2Fb3B0PW1pc2NsaW5rcyZpZD0z>, 2012.

[24] Government of Pakistan, *Pakistan Economic Survey 2011-12*.
During July-April 2012 another Rs2.54 billion was spent on 46 housing schemes that would benefit 15,000 workers.

has grown into a major conglomerate in the country, called Fauji Group, with investments in fertilizer, cement, food, power generation, gas exploration, liquefied petroleum gas (LPG) marketing and distribution, financial services, employment services, and security services. In 2012, Fauji Group had a net worth of Rs76 billion, annual turnover of Rs123 billion, net profit of Rs27 billion, and expenditure on welfare services of Rs6.6 billion. Welfare services include health care, education and vocational/technical education. The Foundation also provides opportunities for employment to ex-servicemen but 60% of the workforce is drawn from the civil sector. The number of its beneficiaries is 9 million or 5% of the population.[25]

Health-related shocks are among important factors in the decline of vulnerable households into the ranks of the poor but social health insurance programs are in their infancy in Pakistan. Civil servants, both serving and retired, and their dependents are provided fairly comprehensive health cover. In the private sector, health insurance schemes exist but are optional and the practice differs across establishments. The National Rural Support Program, in collaboration with Adamjee Insurance, has been providing micro health insurance (or insurance for the poor) to its clients since 2005. In 2011-12, it covered 1.8 million clients in 28 districts. Clients pay a premium of Rs100 per annum and the insurance covers up to Rs15,000 in medical expenses. In June 2013, the total number of microcredit linked micro insurance holders was 3.17 million, with health insurance holders at 1.38 million and life insurance holders at 1.79 million, and the total sum insured at Rs42 billion.[26] BISP has a group life insurance program linked with State Life Insurance, which had 4.1 million beneficiaries in November 2012. BISP has also entered the area of micro health insurance but this is as yet at a pilot stage.[27] A World Bank report on social protection takes the position that ‘many of the conditions that favor [mandatory social health insurance] are not evident in Pakistan’.[28]

2.3 Microfinance Programs

There are a number of programs that supplement the social safety net programs. The Planning Commission Annual Plan 2012-13 distinguishes between the various programs targeted at different categories of the poor and non-poor. Starting from the lowest rung, the categories are: (1) extremely poor, (2) ultra poor, (3) poor, (4) vulnerable, (5) quasi non-poor, and (6) non-poor.[29] According to the Plan, *safety net programs* are targeted at categories 1 and 2; the

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[25] S. Nishtar, ‘“Playing” social protection with a new stack of cards!’ *Blue Chip*, Vol. 3, issue 28, 2006; Fauji Foundation Pakistan, ‘Fauji Foundation Pakistan Trust for the Welfare of Ex-Serviceman and their families’, <http://www.fauji.org.pk>, 2012, (accessed May 2013).

[26] A. Arshad, *Microwatch on Microfinance Outreach in Pakistan*, issue 28, <http://www.microfinanceconnect.info>, 2013 (accessed 3 November 2014).

[27] Benazir Income Support Programme, ‘Benazir Income Support Programme’, <http://bisp.gov.pk>, 2012, (accessed 1 Nov. 2012); Benazir Income Support Programme, ‘Recent Updates of Waseela-e-Sehet (Health and Group Life Insurance)’, op. cit.

[28] World Bank, *Social Protection in Pakistan*, p. 100.

[29] Government of Pakistan, *Annual Plan 2012-13*, Planning and Development Commission of Pakistan, Islamabad, 2013.

microcredit programs are targeted at categories 3 and 4, and the *microfinance programs* are targeted at categories 2-5. The strategy is to provide safety nets to the extremely poor and ultra poor, and help the poor to graduate out of poverty through microcredit and microfinance programs.[30]

Microfinance consists of microcredit, micro savings and micro insurance programs. These programs are largely donor-funded. The state of micro insurance program was discussed in section 2.2. Microcredit is provided through specialized microcredit banks, such as Khushali Bank Limited, microfinance institutions, rural support programs and other microfinance providers. As of end-June 2013, there were 2.64 million active borrowers with a gross loan portfolio of Rs47 billion. The number of potential microcredit borrowers is estimated to be 27.4 million. This gives a penetration rate of 9.6%.[31] In comparison, in 2007, the penetration rate was over 60% in Bangladesh and Sri Lanka, 9% in India, and 14% in Nepal.[32]

Micro savings are exclusively undertaken by State Bank-regulated financial institutions (microfinance banks), but other microfinance institutions can help in mobilizing savings from members and clients. As of June 2013, total micro savings stood at Rs30 billion with 5.2 million active savers.[33]

2.4 Asset Transfer Programs

Cash transfer programs help the poor to deal with poverty. Microfinance programs, in theory, help the poor to graduate out of poverty. Asset transfer to the poor is another avenue to help the poor break out of the cycle of poverty. The assets take various forms: physical, financial, human, social and natural.[34]

Conditional cash grant programs that focus on human development (eg schooling of children or skill acquisition) may be considered part of this category since they aim to help poor households accumulate human assets to transition out of poverty.

The most well-known example of natural asset transfer in Pakistan are the land transfers carried out under the West Pakistan Land Reforms Regulation (1959) during the martial law regime of General Ayub Khan and under the Land Reform Regulation of 1972 when Z. A. Bhutto was Chief Martial Law Administrator. A 1981 study provides an assessment of these two land reforms in terms of their implementation but we are not aware of any study that analyses the effect of land redistribution on the beneficiaries in terms of productivity, inequality and

[30] ibid., pp. 168-169.
[31] Arshad, op. cit.
[32] World Bank, *Social Protection in Pakistan*.
[33] Arshad, op. cit.
[34] C.O. Moser, *Asset-based Approaches to Poverty Reduction in a Globalized Context*, Global Economy and Development Working Paper No. 01, The Brookings Institution, Washington, D.C., 2006.

poverty.[35] The evidence from land reform in India is that, in the aggregate, land-ceiling and land-consolidation legislation had a negative and significant effect on agricultural productivity while the impact of tenancy reform legislation on productivity was positive but insignificant. However, in West Bengal, tenancy reforms increased agricultural productivity. The tenancy reforms in West Bengal involved limited transfer of property rights, and were implemented more effectively than in other states. Tenancy reform also had the effect of increasing inequality of operational land holdings in India.[36]

Other examples of asset transfers in Pakistan are the 5-marla scheme under Z. A. Bhutto and grants of proprietary rights in *katchi abadis* (squatter settlements) to the dwellers by various provincial governments under the *katchi abadi* acts.[37]

In recent years, the effect of asset transfers has been explored in randomized control trials (RCTs) carried out in 44 districts across Pakistan with support from the Pakistan Poverty Alleviation Fund. The approximate value of each asset transfer was Rs50,000 and the assets included livestock, poultry, agricultural tools, tailoring equipment, donkey carts, rickshaws, carry carts, tool kits, etc. An assessment survey of 300 households reveals that, over the period 2008-2012, the income of beneficiaries increased by 178% while that of non-beneficiaries increased by 41%. The effect of asset transfers on beneficiaries' perception of their social status and on their consumption and savings was also substantial. One of the key lessons from this program is that asset transfers combined with quality training perform better in terms of graduation out of poverty than just asset transfers. Although asset transfers increase security, reduce vulnerability of households, and provide a buffer against economic shocks, they do not suffice alone for economic transformation.[38]

A similar RCT-based study in Bangladesh also found that the transfer of assets and skills had a significant effect on the recipients' occupational structure, productivity and incomes, and helped women beneficiaries come out of extreme poverty.[39]

While the transfer of assets and skills entails a considerably larger resource commitment than cash transfers, it holds greater promise of sustainable graduation out of poverty.

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[35] M. H. Khan, *Underdevelopment and Agrarian Structure in Pakistan,* Westview Press, Boulder, Colorado, 1981.

[36] A.V. Banerjee, P.J. Gertler & M. Ghatak, 'Empowerment and efficiency: tenancy reform in West Bengal', *Journal of Political Economy*, Vol. 110, issue 2, 2002, pp. 239-280; M. Ghattak & S. Roy, 'Land reform and agricultural productivity in India: a review of the evidence', *Oxford Review of Economic Policy,* Vol. 23, issue 2, 2007, pp. 251–269.

[37] *The Punjab Katchi Abadis Act, 1992 (VIII of 1992).*

[38] Pakistan Poverty Alleviation Fund, 'Targeting the ultra-poor – asset transfers for poverty alleviation and reduced vulnerability in Sindh', paper presented at *Social Protection Dialogue*, Islamabad, 2013.

[39] O. Bandiera, R. Burgess, N. Das, S. Gulesci, I. Rasul & M. Sulaiman, *Can basic entrepreneurship transform the economic lives of the poor?* Economic Organisation and Public Policy Discussion Paper No. 43, Suntory and Toyota International Centers for Economics and Related Disciplines, London School of Economics and Political Science (STICERD)/London School of Economics and Political Science (LSE), <http://sticerd.lse.ac.uk/dps/eopp/eopp43.pdf>, 2013, (accessed 1 November 2014).

3. Comparison of the Social Protection Program in Pakistan with Other Countries

Table 1 provides a comparison of the coverage of the poorest 20% of the population by social protection and labour programs in Pakistan and in other South Asian countries. As the table shows, social protection coverage of this quintile was considerably lower in Pakistan in 2011 compared to other South Asian countries in 2007-11.

Table 1: Coverage [a] of Social Protection Programs (%): Comparison with South Asia 2007-2011

Poorest 20%		
	Pakistan [b]	South Asia
All Social Protection and Labour	19.1	28.7
All Social Insurance	12.6	9.0
All Social Safety Assistance	7.8	18.1

[a] Coverage is defined as: (number of individuals in the quintile who live in a household where at least one member receives the transfer)/(number of individuals in that quintile).
[b] The data for Pakistan is for 2011. The data for other South Asian countries varies between 2007 and 2011.
Source: World Bank, *The 2011 Atlas of Social Protection: Indicators of Resilience and Equity*, <http://datatopics.worldbank.org/aspire/home>, 2014, (accessed 9 December 2014).

BISP, a social safety net program, was targeted to reach 5.5 million families in 2012-13.[40] This target population is also the poorest 18% of the population of the country identified through a survey conducted in 2008-10. Thus, the social safety net was expected to cover 90% of the poorest 20% of the population in 2012-13.[41] In terms of social safety net/social safety assistance, Pakistan emerges well ahead of the 2007-11 level of coverage in other countries in the region. However, the wider coverage of BISP does not necessarily mean that the Rs1200 per month provided to the poorest households under the program in 2013-14 is sufficient to lift individuals or households out of poverty; the degree of social assistance provided by other countries in recent years also needs to be looked at for comparisons to be meaningful.

[40] This is stated on the BISP website (Benazir Income Support Program, op. cit.). The figure has not been updated. Actual expenditure on cash transfers was Rs40 billion in 2012-13, compared with the budgeted amount of Rs70 billion (Government of Pakistan, *Budget in Brief 2013-2014*). The expenditure during July-March 2014 on cash transfers was Rs48 billion and reached 5.25 million families (Government of Pakistan, *Annual Plan 2013-14*).
[41] According to the BISP website (Benazir Income Support Program, op. cit.), the BISP social safety net coverage extends to 40 percent of the population below the poverty line.

4. Pro-poor Expenditures

The Government of Pakistan has been monitoring expenditures in seventeen sectors of the economy that have been identified as pro-poor. These were first outlined in the Poverty Reduction Strategy Paper I (PRSP-I) which provided a framework for accelerating economic growth and poverty reduction in Pakistan.

In 2005, the Fiscal Responsibility and Debt Limitation Act was unanimously passed by both houses of parliament. The Act provided for greater transparency to fiscal operations and firmer discipline in the government's borrowing and debt strategies.[42] It stipulated that social and poverty-related expenditures would not be reduced below 4.5% of GDP in any given year, and that budgetary allocations on health and education would be doubled as a percentage of GDP over the ten years ending June 2013.[43]

The PRSP-II also lists expenditures (by sectors) to be regarded as pro-poor expenditures. These expenditures are broadly the same as those outlined in PRSP-I except that some expenditure categories are broader than under PRSP-I, eg the expenditure category 'Irrigation' is replaced by Agriculture and includes expenditures on livestock, fisheries and forestry in addition to irrigation.[44] Pro-poor expenditures, as defined in PRSP-II, for the period 2008-2013 are provided in Table 2. In 2012-13, these expenditures were 8.5% of GDP.

[42] Government of Pakistan, *PRSP-II*, p. 15. The Act defines 'Social and Poverty Related Expenditures' as expenditures under the following fifteen heads: highways, roads and bridges; water supply and sanitation; education; health; population planning; social security and other welfare; natural calamities; irrigation; land reclamation; rural development; food subsidies; sub-ordinate judiciary; law and order (only the development aspect); village electrification; and food support program. The Act also allows 'other such expenditures as may be specified in the National Poverty Reduction Strategy Paper' to be included in this category.

[43] Government of Pakistan, *PRSP-II*, p. 292.

[44] Budgetary expenditures under the following seventeen heads are treated as pro-poor in PRSP-II: (1) Roads, highways and bridges, (2) Water supply and sanitation, (3) Education, (4) Health, (5) Population planning, (6) Social security and welfare (BISP and others), (7) Natural calamities, (8) Agriculture (includes budgetary expenditures on livestock, fisheries and forestry in addition to irrigation), (9) Land reclamation, (10) Rural development, (11) Subsidies (includes subsidies for financial and fiscal affairs [dairy, Utility Stores Corporation for sale of wheat], commercial affairs [oil, electricity], and food), (12) Food Support Program (including PBM), (13) People's Work Program I, (14) Rural electrification (People's Work Program II), (15) Low cost housing, (16) Administration of justice, (17) Law and order (current and development). (Government of Pakistan, *PRSP-II*, pp. 270-290)

Table 2: Pro-poor Expenditures 2008-2013

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Total Expenditures (Rs billion)	573	977	1111	1514	1938	1911
Pro-poor expenditures as percentage of GDP [a]	5.39	7.4	7.47	8.3	9.67	8.5

[a] GDP figures are taken at current basic market prices.
Sources: Government of Pakistan, *Pakistan Economic Survey 2012-13*; Government of Pakistan, *Pakistan Economic Survey 2013-14*; Government of Pakistan, *Revised PRSP Budgetary Expenditures for FY 2011-12 and FY 2012-13*; Government of Pakistan, *Poverty Reduction Strategy Paper,* PRSP Secretariat, Finance Division, Islamabad, 2008; UNDP and Federal Bank of Cooperatives, *Poverty Reduction Strategy Paper: Annual Progress Report FY 2008/09,* PRSP-Finance Division, Government of Pakistan, Islamabad, 2009; Government of Pakistan, *The Poverty Reduction Strategy Paper (PRSP): Annual Progress Report for FY 2009/10,* PRSP Secretariat-Finance Division, Ministry of Finance, Islamabad, 2010; Author's calculations.

According to Gazdar, 'The PRSP matched a wide range of sectors to poverty-reducing expenditures without an analysis of the impact of those expenditures on diverse sectors such as infrastructure, construction, education, including higher education, and law and order. The PRSP met its target of taking poverty-focused expenditures to above 4% of gross domestic product (GDP) by 2005/6, but much of this increase occurred in sectors where the poor or the vulnerable were not direct beneficiaries.'[45] This criticism of the PRSP-I applies equally to PRSP-II.

5. Fiscal Space for Social Protection

'In its broadest sense, fiscal space can be defined as the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position.'[46]

The total expenditure on social assistance was about 0.8% of GDP in 2012-13. This expenditure level is considerably less than the average for developing countries, and therefore a case can be made for expanding the scale of the program. It is argued, in this section, that a reduction in subsidies to the non-poor, reform of energy prices, better governance, return to the historical growth path, improvement in the tax-GDP ratio – which is currently one of the lowest in the

[45] Gazdar, op. cit., p. 4.
[46] S.P. Heller, *Understanding Fiscal Space*, IMF Policy Discussion Paper 05/4, International Monetary Fund, 2005, p. 3.

world, and public-private partnership, can create the fiscal space required to sustain or enhance the present level of expenditures on the social safety net.

International or domestic borrowing can be desirable for financing one-off expenditures or expenditures that create conditions for repayment of debt in the future, eg infrastructure investments. Social assistance programs that allow economically marginalized sections of the population to become more employable and to graduate out of poverty could also be treated at par with other development expenditures/programs that create conditions for repayment of domestic and international debt. But these returns will accrue in the long run, and borrowing (domestic or international) to support social safety net expenditures would mean adding about Rs180 billion per year (at 2013 prices) to national debt.

International grants may be available for now for the high-profile BISP, but these cannot be treated as a sustainable basis for a large-scale, long-term social assistance program.

Similarly, seigniorage is ruled out as a sustainable basis for financing social protection.

5.1 Subsidies to the Non-Poor

The total value of federal subsidies in 2012-13 was Rs358 billion or about 1.6% of GDP. These included subsidies to the power sector (96.1%), food and agriculture (2.4%), oil refineries (1.0%) and others (0.5%).[47]

The power subsidy has been rising in recent years because, while the international price of oil has increased, raising the cost of electricity generation, the increase has not been fully passed on to consumers. The effect of this electricity tariff policy is that consumers with a monthly consumption of less than 700 units received a subsidy of Rs180 billion in 2012. Of this, the subsidy to lifeline consumers whose consumption was below 50 units per month was only Rs4 billion.[48]

A 2011 study found that only 4 percent of the total electricity consumption was in the highest two slabs, ie 300-700 units and 700 units and above.[49] The biggest beneficiaries of tariff subsidies in the 2011 were the richest 20% of the population who received about 30% of the subsidy, while the poorest 20% received the smallest share of subsidies, about 10%. The richest 40% of the population received more than 50% of the total subsidy.

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[47] Government of Pakistan, *Fiscal Policy Statement 2013-14.*

[48] Government of Pakistan, *Federal Budget Speech 2011-12,* Ministry of Finance, Islamabad, 2012. Presenting the budget for 2011-12, the finance minister said: 'We are providing electricity at one-sixth the cost of production to about eight million lifeline families whose consumption is below 50 units per month. Instead of paying Rs. 600 per month, they need to pay less than Rs. 100. The total subsidy given on electricity on consumption under 700 units in a month comes to around Rs. 180 billion annually.' (ibid.)

[49] C.Trimble, N. Yoshida, & M. Saqib, *Rethinking Electricity Tariffs and Subsidies in Pakistan,* World Bank, Washington, D.C., 2011.

Another major form of subsidy which is received largely by the non-poor (including lower, middle and upper income groups) concerns the consumption of natural gas and LPG/compressed natural gas (CNG). The subsidy may be measured in terms of the gap between the energy-equivalent world price of fuel and the price paid by consumers of these fuels. This is an implicit subsidy and would not appear as a budgetary subsidy. The implicit subsidy was at least Rs127 billion in 2010-11 (see Box 1).

Box 1

1 Gasoline Gallon Equivalent (GGE) = 126.67 cubic feet of compressed natural gas = 2.567 kilograms (kg) of compressed natural gas (CNG) (Gasoline gallon equivalent, 2014)[a]

1 American gallon = 3.785 litres

The consumer price of gasoline (motor gasoline) in 2010-11 was about Rs75.5 per litre (the average ex-depot price ignoring margins over ex-depot price).[b]

The price of a gallon of gasoline was Rs75.5 x 3.785 = Rs286.

The maximum price of 1 kg of CNG as fixed by the Oil and Gas Regulatory Authority (OGRA) to be charged to consumers was Rs55-57 (approx.), or about Rs144 for 2.567 kg of CNG [c]

Thus, for every 2.567 kg of CNG or 126.67 cubic feet of CNG, the implicit subsidy was:

Rs286 – Rs144 = Rs142

Since the CNG consumption of natural gas was 113,055 million cubic feet (mmcft) for 2010-11,[d] the subsidy on total CNG consumption of natural gas can be calculated as:

Rs (142 × 113055000000)/126.67 = Rs127 billion

[a] *Wikipedia*, 'Gasoline gallon equivalent', <http://en.wikipedia.org/wiki/Gasoline_gallon_equivalent>, 2014.
[b] Starting in August 2011, CNG prices increased to the range Rs 63-89 from Rs 55-57 in 2010-11. The effective implicit subsidy would be much less in this period.
[c] Oil and Gas Regulatory Authority, 'Notification', <http://www.ogra.org.pk/images/data/downloads/1280469138.pdf>, Islamabad, 29 July 2010 (accessed 4 November 2014).
[d] CNG prices have been revised upwards since 2010-11. Whether this entails an increase or decrease in the CNG-related implicit subsidy, we need to compare the change with the change in the energy equivalent price of gasoline.

The subsidy on natural gas is provided to other consumers of natural gas as well, in particular domestic consumers of natural gas. The lowest price slab was for households that consumed less than 3.55 mcft[50] per month in 2010-11. For these households, the cost of natural gas was Rs95 per mcft. The likely alternatives to natural gas for households are kerosene (for cooking) and electricity/coal (for heating). A household that used 3.55 mcft of natural gas per month paid Rs

[50] 3.55 mcft = 3.55×1000 (cft)

(3.55)(95) = 337.25 per month. Such a household consumed the energy equivalent of 98.41 litres of crude oil per month for cooking/heating.[51] The price of equivalent energy units, which we approximate by the price of kerosene,[52] at the rate of Rs74/litre, is Rs (98.41)(74) = Rs7,282. The effective subsidy was thus Rs6,945 per household in the slab that consumed up to 3.55 mcft.[53] The per unit implicit subsidy declined at higher levels of consumption but was retained even at the highest tariff slab. The nature of natural gas tariffs was such that the first 3.55 mcft was charged at the rate of Rs95, the next 3.55 mcft at the rate of Rs190, and so on. Since there was an implicit subsidy at every slab, the aggregate subsidy was greater for the bigger consumers of gas, who could be expected to be the rich households. Therefore, the richer the household, the greater was the implicit subsidy on domestic consumption of natural gas in 2010-11.

To summarize, there are implicit and explicit subsidies in the energy sector and the rich are the major beneficiaries of these subsidies. The richest 20% were the beneficiaries of 30% of the total power sector subsidies of Rs464 billion in 2011. The implicit subsidy on CNG, by no means targeted at the poor, was Rs127 billion in 2011. In comparison, about Rs155 billion was spent in total on the social assistance program in 2010-11. Clearly, there is enormous scope for creating fiscal space for maintaining or expanding the scope of the social protection program in Pakistan through reduction in these subsidies.

5.2 Losses of Public Sector Enterprises and Governance Failure

Resources for social protection can also be made available through cost cutting and better governance in the public sector. An analysis of the full range of such economies is outside the scope of this work but the magnitude of the losses in the public sector enterprises provides an idea of the efficiency gains possible and the extent of resources that can be harnessed. Table 3 provides figures on the losses of some major PSEs.

[51] In energy equivalent terms, 1 mmcft of natural gas = 1000 mcft of natural gas = 174.363 barrels of crude oil = (159)(174.363) (= 27723.717) litres of crude oil. Thus 1 mcft of natural gas = 27.72 litres of crude oil and 3.55 mcft of natural gas = 98.41 litres of crude oil (Government of Pakistan, *Pakistan Energy Yearbook 2011*, Hydrocarbon Development Institute of Pakistan, Ministry of Petroleum and Natural Resources, Islamabad, 2012; Government of Pakistan, *Pakistan Economic Survey 2011-12*).

[52] From the conversion table provided by the National Energy Board (NEB), Canada, the energy content of 1 cubic meter of crude oil ranges between 35.17 gigajoules (GJ) and 40.90 GJ depending on the type of crude, pentanes, light or heavy, and the energy content of 1 cubic meter of kerosene is 37.68 GJ. Therefore it is reasonable to assume that the price of a litre of crude oil is roughly the same as the price of a litre of kerosene in terms of energy units. (National Energy Board, 'Statistics - energy conversion tables', *National Energy Board*, <http://www.neb.gc.ca/clf-nsi/rnrgynfmtn/sttstc/nrgycnvrsntbl/nrgycnvrsntbl-eng.html#s4ss>, Government of Canada, n.d.)

[53] This set of calculation is repeated for 2011-12 using the weighted average (by the number of days for which the price was effective) of price of kerosene as well as the weighted average (by the number of days for which the price was effective) of the price slab for households that consumed less than 3.55 mcft per month. The calculation could not be weighted by the monthly consumption data. Without accounting for consumption, the effective subsidy for the household that consumed up to 3.55 mcft is calculated as Rs. 8,518.

Table 3: Losses in Selected Public Sector Enterprises, 2011-2013 (Rupees billion)

Year	Pakistan Steel	Pakistan Railways	Pakistan International Airlines (PIA)
2010-11	12.43	31.16	20.8
2011-12	21.43	31.05	26.8
2012-13	23.00	31.41	33.2

Sources: *Dawn*, 'Pakistan Steel Mills in a tailspin', 15 Jul. 2013; F. Zaheer, 'Pakistan Steel Mills: losses mount as raw material supplies dry up', *The Express Tribune*, 10 Oct. 2011; Pakistan Railways, *Pakistan Railways Yearbook 2010-11*, 2010; National Assembly Secretariat, 'Questions for oral answers and their replies to be asked at a sitting of the National Assembly to be held on Friday, the 30th August, 2013', <http://www.na.gov.pk/uploads/documents/questions/1377852056_243.pdf>, Islamabad, 30 Aug. 2013; Pakistan International Airlines, *PIA Annual Report*, 2011; and State Bank of Pakistan, *Annual Report 2012-13*.

The losses of PSEs do not capture the opportunity cost of the investments made in these corporations and the foregone return on the capital invested in these projects. For example, the total assets of PIA in 2011 were Rs127 billion rupees (most of these would be carryover assets and not valued at market prices) on which a return on assets (ROA) comparable with Philippine Airlines of 4.3% in 2010[54] would imply a profit of Rs5.5 billion instead of a loss of Rs20.8 billion in 2011. The same argument applies to other loss-making PSEs and even profitable PSEs.

Losses of distribution companies (DISCOs) in the power sector comprise another source of subsidy. The inability of DISCOs to collect utility bills is recorded initially as an 'amount receivable', but some of these amounts have to be written off eventually by the government. In 2012, the amount receivable by DISCOs was Rs354 billion (in February 2012) and the amount payable was Rs394 billion (in April 2012).[55] Of the amount receivable, about half consisted of unpaid bills by domestic consumers and the remainder comprised mostly of unpaid bills by provincial governments, the Federally Administered Tribal Areas (FATA) and the Karachi Electric Supply Company (KESC).[56] Buildup of the amount receivable is one of the important causes of circular debt, which amounted to Rs872 billion or 4% of GDP in 2012. As the amount receivable accumulates, the Central Power Purchase Authority (CPPA) is unable to pay its bills to oil and gas companies, independent power producers (IPPs), the Water and Power Development Authority (WAPDA) and other suppliers. When suppliers withhold their supplies, because of non-payment of bills, power shortfall results and eventually the federal government is forced to clear the outstanding dues.

[54] C. Ansay, *Airline Industry*, presentation posted on SlideShare, <http://www.slideshare.net/catansay/airline-industry-10446667#btnNext>, 2011.
[55] Government of Pakistan, *Pakistan Economic Survey 2011-12*, pp. 193-220).
[56] Government of Pakistan, *The Causes and the Impact of Power Sector Circular Debt in Pakistan*, USAID and Planning Commission of Pakistan, Islamabad, 2013.

A report commissioned by the Planning Commission and funded by the United States Agency for International Development (USAID) identifies the key reasons for circular debt and large-scale load-shedding as governance failure at multiple levels, including policy making, price setting, budgetary planning and allocation, revenue collection, dispute resolution, etc.[57]

Addressing the governance issues in public sector companies and public sector institutions in general will reduce losses and improve efficiency, and allow the channelling of public sector funds to resource-starved social infrastructure, including social protection programs.

5.3 Economic Growth and Fiscal Space

Between 2007-08 and 2012-13, Pakistan's economic growth rate averaged 3.2% compared with the historical average, from 1970 onwards, of about 5% and an average of 7.2% in the previous four years, 2004-2007.

A one-percent increase in economic growth adds about Rs200 billion to the GDP (in 2013 prices); at a tax-GDP ratio of about 10% in 2013, this adds about Rs20 billion to tax revenue. If the economy had maintained a modest growth of 5% between 2008 and 2013, instead of the actual 3.2%, an additional Rs36 billion would have been available annually in tax revenues during the last four years.

The slow growth can be attributed to several factors, over some of which the government had relatively little control. Among these were natural calamities (major floods in 2010 and 2011), increase in international fuel prices, and the insurgency in Swat and FATA with its fallout on domestic law and order and the investment climate. In assessing prospects for a revival of growth to its historical level, it has to be considered whether these factors and their consequences are likely to be temporary or persistent.

Natural calamities are difficult to predict, and the effects of militancy on the investment climate may persist for quite some time. With the exit of NATO and coalition forces from Afghanistan in 2014, dealing with insurgency will pose a different set of challenges. Not all militancy in the country can be attributed to Pakistan's support of foreign forces in Afghanistan, but to the extent that it can be, the withdrawal of forces in 2014 is expected to reduce violence and improve the security environment in Pakistan.

The increase in energy prices since 2004 has been a major factor that has affected economic growth. The import unit value index of minerals, fuels and lubricants, which was 306 in 2003-04, climbed up to 877 in 2007-08 and was 1256 in 2010-11, 1652 in 2011-12 and 1721 in 2012-13.[58] The escalation in international oil prices resulted in increased cost of electricity generation, which was heavily dependent on imported fuel.

[57] ibid.

[58] State Bank of Pakistan, *Annual Report 2012-13*.

The government was slow in adjusting electricity prices to the higher cost of production and absorbed the increase in the form of subsidies. The problem was accentuated by non-payment of utility bills by consumers and the governance failure mentioned earlier.[59]

The burden of subsidies, arising largely from the power sector, also increased the fiscal deficit, which ranged from 5.2 to 8.0 percent of GDP between 2009 and 2013. To finance its deficit, the government also relied on borrowing from the central bank (printing money) and from commercial banks. Revenue from printing money can be measured by changes in reserve money.[60] During 2009-2013, the government earned revenue in the range of 0.22% of GDP and 1.59% of GDP because of its monopoly over printing money (see Table 4).

Table 4: Changes in Reserve Money Stock (2009-2012)

	2008/09	2009/10	2010/11	2011/12	2012/13
Change in Reserve Money (Rs billion)	27.5	172	287	223	346
Percentage Change in Reserve Money	1.86	11.39	17.06	11.34	15.82
Seigniorage [a]	0.22	1.16	1.59	1.08	1.51

[a] Seignorage is calculated as the change in high powered money balances as a percentage of GDP.
Source: State Bank of Pakistan, *Annual Report 2011-12,* Karachi, 2012.

The financing of deficit by borrowing from the central bank has contributed to inflation and eroded the real value of cash transfer under the safety net programs. Even moderate levels of seigniorage involve very high rates of inflation.[61] The consumer price index increased from 112 in July 2008 to 170 in June 2012. Thus, the real value of the cash grant approved for the poor households under BISP in the 2008-09 budget was reduced from Rs1000 per month in July 2008 to Rs659 in June 2012.

The fiscal deficit and its financing also had consequences for private investment in the country. An attractive interest rate on secure government bonds diverted commercial bank credit from the private to the public sector. Private sector credit declined from 28% of GDP in 2007-08 to 14.7% in 2012-13 and aggregate investment collapsed from 19% of GDP in 2007-08 to 14.2% in 2012-

[59] S. Ali & S. Badar, 'Dynamics of circular debt in Pakistan and Its resolution', *Lahore Journal of Economics*, Vol. 15, issue SE, 2010, pp. 61-74; Government of Pakistan, *The Causes and the Impact of Power Sector Circular Debt in Pakistan*, USAID and Planning Commission of Pakistan, Islamabad, 2013.
[60] For other measures of seigniorage see W. H. Buiter, *Seigniorage*, Working Paper 12919, National Bureau of Economic Research, Cambridge, MA, <http://www.nber.org/papers/w12919>, 2007.
[61] D. Romer, *Advanced Macroeconomics,* McGraw Hill, 2001, p. 541.

13.[62] Of course, the uncertain law and order situation and power outages were also likely causes of the decline in investment.

To summarize, one of the consequences of slow growth is that it reduces the space for social protection. Weak governance and poor economic management are among the major reasons for the slow growth rate but exogenous factors and shocks such as floods, insurgency and energy price escalation should not be underestimated. The economy remains vulnerable to weather-related shocks and the post-2014 security environment also remains uncertain. A number of macroeconomic problems can be traced to the escalation in oil prices since 2008 and the inability of the government to reform the energy sector. If governance reforms in the energy sector are undertaken, if electricity prices are allowed to reflect the higher cost of production, and if revenue collection from consumers of electricity is strengthened, the problem of fiscal deficit and many of the related macroeconomic problems can be addressed. This can also spur economic growth in the short run. Long-term competitiveness and economic growth will require harnessing cheaper sources of energy and power generation.

5.4 New Tax Measures

Increasing the tax effort can also create the fiscal space for social protection. Pakistan has one of the lowest tax-to-GDP ratios in the world. In 2013, this ratio was 9.8%. At the federal level the two main sources of tax revenue are the general sales tax (GST) and income tax. Their relative shares in total federal tax revenue in 2012-13 were 41.5% and 36%.

On November 24, 2008, the International Monetary Fund (IMF) approved a 23-month $7.6 billion (SDR 5.169 billion) Stand-By Arrangement (SBA) to support the Government of Pakistan's program for economic stabilization. The proposed program included a wide range of measures including the implementation of full VAT with minimal exemptions.[63] Over the medium term (until 2012-13), the government committed itself to increasing tax revenue by at least 3.5 percentage points of GDP through measures to broaden the GST base, reduction in tax exemptions and improvement in tax enforcement.[64]

The effort by the government to introduce VAT was scuttled by opposition parties and some of the coalition partners of the government. Collection of sales tax on goods remains well below the level of lower middle-income countries. Sales tax on services that was previously being collected by the federal government on behalf of the provinces is now being collected by provincial

[62] State Bank of Pakistan, *Annual Report 2012-13.*
[63] World Bank, *Pakistan Tax Policy Report: Tapping Tax Bases for Development.* World Bank, Washington, D.C., 2009. The VAT had the potential of raising Rs400 billion to Rs700 billion in tax revenues for the government in 2008 (ibid.).
[64] S. Tarin & S. Akhtar, 'Pakistan: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding' [letter to IMF Managing Director], <http://www.imf.org/external/np/loi/2008/pak/112008.pdf>, 20 Nov. 2008.

revenue authorities in Punjab, Sindh and KP. This seems to be a buoyant source of revenue for the provinces but collection efficiency is a fraction of the full potential.

Income tax is the other major source of tax revenue. It is capable of generating much greater tax revenue but the tax base has been eroded because of tax exemptions, tax concessions and tax evasion. Tax complexity and weak audit and tax administration reinforce non-compliance and tax evasion. The role of interest groups and lobbies that have won tax concessions and tax exemptions, remain ubiquitous. A World Bank study estimated the revenue loss from non-compliance to be Rs450 billion for corporate income tax and Rs31 billion for individual income tax in 2008.[65] In 2010-11 the percentage of population that filed tax returns in Pakistan was 0.5% compared with 4.7% in India.[66] In theory, the burden of the income tax should fall disproportionately on the rich but without proper enforcement the progressivity of the tax is seriously undermined.

Provincial governments also have two other sources of tax revenue, namely agricultural income tax and urban immovable property tax, but these are poorly tapped. Tax on agricultural income, which in effect is a per-acre land tax, raised less than Rs1 billion in 2013 compared with the actual potential of about Rs50 billion if agricultural income was taxed at rates applicable to similar incomes in other sectors of the economy.[67] Similarly, tax collection from urban immovable property tax was Rs7.7 billion in 2013 or 0.034% of GDP. This ratio is 0.5% in countries with a similar level of development.[68]

Pakistan has one of the lowest tax-to-GDP ratios in the world. In 2013, this ratio was 9.8%. New tax measures will not burden taxpayers any more than in comparable countries. The poor bear a heavy burden of implicit inflation taxation. This form of taxation needs to be replaced by taxes that are more equitable.

5.5 Public-Private Partnership

If greater private investment is encouraged in areas traditionally dominated by the public sector, it will allow greater budgetary resources to be diverted to social protection. Public-private partnership opportunities can also be exploited in the delivery of services that are part of a conditional cash grant program, eg schooling or skills development.

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[65] World Bank, *Pakistan Tax Policy Report*.

[66] Consortium of Development Policy Research (CDPR), *Personal and Corporate Income Tax in Pakistan*, CDPR, Lahore, 2013.

[67] This is based on a projection for the country as a whole using the agricultural income tax estimate for Punjab, which was Rs35 billion in 2013. A. Nasim, ‘Agricultural income tax in Punjab: tax potential and modes of tax collection’, paper presented at *UNDP International Conference on Participatory Federalism and Decentralization: From Framework to Functionality*, Islamabad, 2013.

[68] R. Bahl, S. Wallace, & M. Cyan, *Pakistan: Provincial Government Taxation,* International Studies Program Working Paper 08-07, Andrew Young School of Policy Studies, Georgia State University, Atlanta, 2008.

The large-scale nationalization of manufacturing and banking under the government of Z.A. Bhutto in the 1970s was dismantled under the military regime of General Zia ul Haq (1977-1988) but more aggressively under Nawaz Sharif's first term in office (1990-1993). In the late 1980s, private investment was encouraged in the power sector, which, until then, had been in the public sector domain. The Hub Power Project was the first major private investment that cleared the way for the 1994 Power Policy of the PPP government under which about 20 independent power plants were set up with a total investment of $5.3 billion.[69] Although, the PML-N regime (1997-1999) was hostile towards IPPs set up under the PPP government, the Musharraf/PML-Q government (1999-2008) encouraged private investment under the Policy for Power Generation Project Year 2002.[70]

Private investment in telecommunications, which began under the first PPP government, also flourished in the 1990s and particularly under the Musharraf/PML-Q government. The private sector has always been dominant in road transport, but in the early 1990s, private airlines were also allowed to operate and have continued to operate on a limited scale on some of the routes. The private sector owns the Sialkot airport, which operates passenger and cargo services domestically and internationally. The Gwadar port was being operated by a Singapore-based firm and its management has now been transferred to a Chinese firm. In the last few years, the private sector has started operating a railway service between Karachi and Lahore.

The private sector has also become a very important player in the education sector at all levels, in both urban and rural areas. In the health sector as well, the private sector is involved from primary to tertiary healthcare. As mentioned earlier, a private insurance company, Adamjee Insurance, is partnering with a rural support program to provide life and health insurance to the poor. The Punjab Economic Opportunities Program (PEOP) also relies heavily on private providers to impart marketable skills and training to the poor.

The private sector in Pakistan is very vibrant and there are several successful examples of public-private partnership. For a government that is seriously resource-constrained, further opportunities for such partnership should be explored. Substitution of public investment by private investment and of public sector delivery of social services by private sector delivery could create greater fiscal space for the government to enlarge the scope of social protection in the country.

[69] J.M. Fraser, *Lessons from the Independent Private Power Experience in Pakistan,* Discussion Paper No. 14, World Bank, Energy and Mining Sector Board, Washington, D.C., 2005, p. 6.
[70] Government of Pakistan, 'Policy for Power Generation Projects Year 2002', Private Power and Infrastructure Board, Ministry of Water and Power, <http://www.ppib.gov.pk/PowerPolicy2002.pdf>, Islamabad, 2002.

6. Concluding Remarks

The social safety net component of social security in Pakistan covers about 18% of the poorest population in the country. The social security component of social protection is largely limited to pension programs and some health cover for civil and military personnel and formal sector employees. The Benazir Income Support Programme has reinvigorated interest and concern for social protection in Pakistan but as a share of GDP, the expenditure on social safety nets is still about half the average of developing and transition countries.

Feasible options exist to make resources available to sustain the present social safety net expenditure, and even increase its scope and coverage, without recourse to greater borrowing or inflationary finance. This paper presented a number of options for creating such fiscal space. These include reduction of implicit and explicit subsidies to the non-poor; improvement in governance of PSEs; price and governance reform in the energy sector which can reduce power outages and have a positive impact on economic growth; introduction of new tax measures, such as a comprehensive VAT, and well-designed income tax at the federal level and agricultural income and urban property taxes at the provincial level; and extending the scope of public-private partnership.

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