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ABBREVIATIONS AND ACRONYMS

| | | | |
|-----------------|--|-----------------|---|
| ADP | Annual Development Plan | KP | Khyber Pakhtunkhwa |
| AEPAM | Academy of Educational Planning and Management | LCU | Local Currency Unit |
| AIT | Agricultural Income Tax | LGO | Local Government Ordinance |
| ANC | Antenatal Care | LHW | Lady Health Worker |
| ARI | Acute Respiratory Infection | MCH | Mother & Child Health |
| ASER | Pakistan Annual State of Education Report | MDG | Millennium Development Goals |
| ASR | Annual Strategy Review | MHSP | Minimum Health Service Package |
| BHU | Basic Health Unit | MRI | Magnetic Resonance Imaging |
| BOR | Board of Revenue | MTBF | Medium Term Budget Framework |
| BPS | Basic Pay Scale | MVT | Motor Vehicle Tax |
| BSU | Basic Health Unit | NFC | National Finance Commission |
| FBR | Federal Board of Revenue | NGO | Non-Government Organization |
| CDS | Comprehensive Development Strategy | NHA | National Health Account |
| CMR | Clinical Microbiology Review | NLGO | National Local Government Ordinance |
| CVT | Capital Value-added Tax | NWFP | North West Frontier Province |
| DDOs | District Development Officer | O&M | Operations and Maintenance |
| DFID | Department for International Development | OBB | Output-Based Budget |
| DI Khan | Dera Ismail Khan | OOP | Out-of-Pocket |
| DOH | Department of Health | ORT | Oral Rehydration Therapy |
| DPC | Development Policy Credit | PBS | Pakistan Bureau of Statistics |
| DOTS | Directly Observed Treatment Short Course | P&DD | Planning and Development Department |
| E&T | Excise and Taxation | PCNA | Post Crisis Needs Assessment |
| E&TD | Excise and Taxation Department | PDHS | Pakistan Demographic and Health Survey |
| EAD | Economic Affairs Division | PEFA | Public Expenditure Financial Accountability |
| EGS | Economic Growth strategy | PEM | Public Expenditure Management |
| EMIS | Education Information System | PFC | Provincial Finance Commission |
| EPI | Expanded Program on Immunization | PFM | Public Financial Management |
| ESP | Education Sector Plan | PGDP | Provincial Gross Domestic Product |
| ETO | Excise and Taxation Officer | PIFRA | Project to Improve Finance Reporting and Auditing |
| FBR | Federal Board of Revenue | PNC | Postnatal Care |
| FD | Finance Department | PPP | Public Private Partnership |
| FRA | Fiduciary Risk Assessment | PSLMS | Pakistan Living Standard Measurement Survey |
| GDP | Gross Domestic Product | R&M | Repairs and Maintenance |
| GER | Gross Enrolment Rate | SAC | Structural Adjustment Credit |
| GIS | Geographical Information System | SBA | Skilled Birth Attendant |
| GNP | Gross National Product | SHMI | Small Household Manufacturing Industries |
| GP Fund | General Provident Fund | SNE | Schedule of New Expenditures |
| GPIF | General Provident Investment Fund | SPDC | Sustainable Policy Development Centre |
| GST | General Sales tax | TB | Tuberculosis |
| HDI | Human Development Index | TFCs | Tax Facilitation Center |
| HEC | Higher Education Commission | TMA | Tehsils Municipal Administrations |
| HIES | Household Integrated Economic Surveys | UIPT | Urban Immovable Property Tax |
| IMF | International Monetary Fund | UN | United Nation |
| IMR | Infant Mortality Rate | UNICEF | United Nations Children Fund |
| ISPPIA | International Standards for the Professional Practice of Internal Auditing | WAPDA | Water and Power Development Authority |
| K-MICS | KP Multi Cluster Survey | WHO | World Health Organization |
| | | WS&S | Water Supply and Sanitation |

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Executive Summary

Introduction

1. Khyber Pakhtunkhwa (KP) is one of the least-developed and crisis-prone provinces in Pakistan. Located in far north of the country, the province covers 10 percent of the total land area and is a home to 13 percent of the country's population spread over seven administrative districts. Majority of the population (83 percent) is rural, averaging 7.6 members per household—well above the national average of 6.6. The literacy rate remains low at 49 percent with more than half of population having no access to tap water while unemployment runs at 8.5 percent. KP's relative underperformance is primarily due to low levels of growth, socio-economic underdevelopment and lack of public services compared to other provinces of Pakistan. It is also prone to militancy, largely due to its proximity to the geo-political conflict in Afghanistan and the vagaries of Mother Nature (catastrophic floods in 2010 and earthquake in 2005)—calling constantly for government and international interventions, and investment to improve the quality of life and unlock its economic potential.

2. Cognizant of the challenges to growth in KP and acting upon the assessment of Pakistan Government's Post-Crisis Needs Assessment (PCNA) of the region in October 2010, the donors agreed on a harmonized approach to meet the short- and medium-term social and economic needs of KP, including the establishment of a Multi-Donor Trust Fund (MDTF). This Public Expenditure Review (PER) of KP was undertaken in partnership with the government of KP and is one of the important outcomes of PCNA funded by the MDTF.

Objectives of the Report

3. The report on Operationalization of Post Crisis Needs Assessment (OPCNA) highlighted the need for strengthening KP's public financial management (PFM) as fundamental to improving public services and therefore the quality of life in KP. The provincial government, realizing this too, has initiated several reforms with the help of UK Government's Department for International Development (DFID) to improve public financial systems. Some of these initiatives are genuinely path breaking in nature and, if followed through with the same zeal and vigor, as shown by the provincial authorities to date, they can be instrumental in removing some of the fundamental weaknesses of budget-making process, and fiscal and financial management regime that exist in KP, and indeed in Pakistan. The most important of these initiatives are the efforts to link strategy and planning to the budgeting process under an 'output-based' Medium Term Budgetary Framework (MTBF). There is need to continue, expand and strengthen the process, as it marks the first genuine effort by any province in Pakistan to bring about budgetary reforms. The fundamental objective of this review is to provide KP government a fresh perspective to these initiatives and act as a catalyst in this process.

4. On the basis of demand from provincial authorities, this report analyzes the overall budgetary, fiscal and financial management system of the provincial government as well as the adequacy and efficiency of expenditure for two major social services, i.e. education and health.¹ Not only are these two services allocated majority of budgetary resources but they are also important, at least in short- to medium-run, for generating income and growth in the remittances-driven economy of KP.

5. The report is organized into three chapters. Chapter 1 reviews the overall aggregate macro fiscal sustainability issues by analyzing the fiscal space, expenditure patterns of recurrent and development budgets, and structural rigidities that hamper effective expenditure management and in the end proposes a menu of reforms. The absence of any official estimate of Provincial Gross Domestic Product (PGDP) made it necessary for this report to make its own PGDP estimate as a benchmark from which to gauge overall expenditure and revenue outlays. Besides analyzing the soundness of the overall provincial expenditure management system, an attempt is also made to identify Technical Assistance (TA) in fiscal and financial management areas that would strengthen the government's analytical and implementation capacity thereby creating an enabling environment for the proposed reforms. Annexure 4 highlights in detail the knowledge and capacity gaps hindering the reform effort and the slowing progress in PFM improvement (as highlighted by PEFA 2007 and 2011). In addition, Annexure 4 also proposes a menu of interventions that government may undertake with the help of donors to act as a catalyst to further the reform process.

Fiscal Policy, Performance and Expenditure Trends

6. Over the last two years, KP's provincial finances have improved markedly, mainly due to increased revenue transfers from the federal government in the form of arrears payments from hydro-electric profits and a new NFC Award which includes 1 percent of undivided divisible pool as compensation against war on terror. This has raised the province's share of federal revenue sharply, from about 7-8 percent of PGDP to 8.7 percent in 2009-10 and 11.3 percent in 2010-11.

7. As a result, KP registered a fiscal surplus of 0.7 percent of PGDP in 2010-11. The report calculates that, on average, KP realized a 3.5 percent of PGDP increase in fiscal space between 2006-07 and 2010-11 over that of the previous five years. Three channels—federal transfers, revenue collection and savings from spending efficiency—have contributed to the expansion of fiscal space, prompting the provincial government to sharply increase both current and development spending, especially the latter. The mix could have been better but for structural rigidities in pay and pensions expenditures. Large pay and pension raises in the last two fiscal years have consumed significant resources. Such constraints have led to inadequate spending on operation and maintenance (a decline by 2 percent to 8 percent of expenditures in 2010-11 from previous year), with adverse consequences for assets maintenance.

8. In Pakistan, provincial autonomy and fiscal sovereignty is emphasized. Yet, there are in-built factors and incentives for continued heavy dependence of provinces on federal revenue transfers. The Constitutional assignment of all major and buoyant taxes to the federal government leaves provinces with tax bases that are difficult and expensive, both financially and politically, to tax. At the same time, with a very large portion of provincial needs met from transfers from the federal government, creates reluctance on part of the provinces to impose tax burden onto the voting population. This at one end maintains the control of center over federating units (i.e. provinces); while at the other, spares the provincial governments the political cost of unpopular fiscal actions. Presently, less than 2.1 percent of KP government's expenditures are financed through provincial revenues and as such expenditure levels are exposed to changes in federal tax policy and its collection.

9. The situation is further exasperated by a provincial fiscal policy that gives little importance to incidence, equity or efficiency of taxes. Fragmented civil administration, where different administrative sets and different rules

¹ The public expenditures which are analyzed in this report only cover registered outlays in the budget.

govern the areas—government and tribal, and inappropriate and complex tax structure, where tax becomes disincentive to expansion and growth of economic activities, serve as constraints. Buoyant components of tax base are largely exempted and no concerted efforts are underway to increase effective rate of tax collection.

10. This report emphasizes that despite recent increase in federal transfers and improved fiscal space, there is hardly room for complacency. In order to finance the development of the province, additional fiscal space is required. The provincial (and local) taxes need to be aligned and reformed to reduce their disruptive impact on economic activity. The province therefore may consider increasing revenue collection by deepening and rationalization of tax structure to improve tax compliance; limiting tax exemptions to expand tax base; implementation of single income tax with amalgamation of profession and calling tax into income tax; and, strengthening and modernizing tax administration.

11. The report acknowledges the strong government ownership of reform initiatives which are taken with a view of strengthening all aspects of public finances. KP adopted a comprehensive fiscal reform program in 2001-02 based on four pillars, namely: (i) enhancing resources; (ii) strengthening ex-ante and ex-post PFM reforms; (iii) fiscal decentralization; and, (iv) instituting an output-based accountability mechanism. In terms of strategy, the reforms have focused on the following four key areas of public finance: (i) enhancing revenue; (ii) reprioritizing expenditures and improving expenditure management; (iii) improving budget preparation, execution and oversight; and, (iv) strengthening the bounds of fiscal decentralization. During last few years, with active support from DFID, the reform has accelerated with government displaying strong ownership of the process. Some of the more recent initiatives are ‘The Integrated Public Financial Management Reforms Strategy’, Medium Term Budget Framework (MTBF), and District Output Based Budgeting (OBB).

12. Despite impressive progress on reforms due to commitment and efforts of the provincial government and DFID support, the report underscores the need to bridge some knowledge and capacity gaps to further accelerate the progress.² To date, expenditure management does not foster linkages of inputs to outputs; and procedural and structural rigidities continue to affect development outcomes. Artificial bifurcation of current and development expenditure budgets perpetuates compartmentalization of budget formulation undermining efficiencies of a more integrated budget making. The bias in favor of wage expenditure (protecting the existing labor force) continues as does the emphasis on inputs rather than outputs. While supporting the provincial reform initiatives, the report makes a case for their effective implementation so as to bring about desired improvements in service delivery and efficiency. This may require dynamic and evolving government machinery that could respond promptly to changes in ground realities. Despite some pockets of excellence within the government structure, disconnect between reforms and their impact on the PEFA scores and service delivery can partly be explained by existing knowledge and capacity gaps.

In order to further improve expenditure management and its efficiency, KP government may need to initiate activities geared towards preparation of debt and pension management strategies, commissioning a study on sustainability of salary budget and its future estimates, and analyzing the relevance of salary budget with service delivery. It may also consider enlarging the pool of professional human resources to implement development activities. This report recommends that KP should put more focus on maintaining the existing physical infrastructure by incurring more operation and maintenance expenditure. It should also ensure predictability of funds, starting with timely release of funds; avoid thin spreading of resources to a large number of projects and enforcement of hard budget constraint favoring project completion vis-à-vis new project launch.

² There is a slow progress in PFM indicators (as highlighted by PEFA 2007 and 2011).

The Education Sector

13. In KP, progress in education-related indicators has started to stagnate. Enrollment in public sector schools has increased by about 6 percent at primary level and almost by 9 percent at secondary level since 2006-07. The net enrolment rate (NER) for 6-10 year olds rose from 51 percent to 64 percent, but has stagnated over the last three years. Stagnation is also apparent in the NERs of other age levels. At this pace, KP will not achieve the MDG target of 100 percent primary enrollment and gender parity at secondary schools by 2015.

14. According to Pakistan Living Standard Measurement Survey (PSLMS) 2011, despite KP's weak performance, about 65 percent of KP households remain satisfied with public schools—the highest of any province and four points higher than the national average. It appears that dissatisfaction is related to the absence of nearby schools, rather than schooling quality. Most households have a primary school close by. Poverty however, remains a big factor hindering access to schooling. The role of private sector, though relatively small compared with Sindh Urban or Punjab, is nonetheless substantial. It is however concentrated in a few prosperous districts.

15. In recent years, ongoing conflict, violence and natural disasters have had a heavy toll on KP's education services. Schools have either been damaged or closed in conflict-affected areas. The July 2010 floods disrupted the provision of education in several districts forcing the government to restructure its budget—diverting resources into flood compensation and rehabilitation.

16. Education expenditure in KP grew at double-digit rates over the last 10 years, with development expenditure increasing at a much faster rate than recurrent. In real terms, total expenditures have grown at an average annual rate of 11 percent. Total nominal expenditures have risen at an average of 20 percent per annum. KP's fiscal emphasis on education is not fundamentally different from that of other provinces—around 26 percent of current budget on education—slightly less than Punjab but more than Sindh.

17. Though allocations for education have increased substantially over the years, they still remain less than adequate to provide at least one teacher per classroom at every class level, or other basic facilities like toilets and boundary walls. Majority of primary schools have two classrooms and two teachers. However, 24 percent of boys' schools and 18 percent of girls' schools continue to have only one teacher.

18. There have been some improvements, especially in girls' schools. The government is making a successful effort to fill the gap of missing facilities at girls' secondary schools. Allocation of resources across boys' and girls' schools is more equitable than expected. The proportion of girls' schools with two teachers is higher than that of boys' schools. Likewise, the proportion of girls' schools with three classrooms is higher than the boys', as is the number of girls' schools with more than six teachers.

19. KP's sectoral priorities, however, are very different from those of other provinces. KP's expenditure on primary education relative to its total education spending is the lowest in Pakistan—15 percentage points less than the share allocated to primary education in Punjab. On the other hand, KP's secondary education share is the highest in the country—9 percent more than Punjab. KP's expenditure per student in public primary schools is the lowest in Pakistan, but the highest for secondary school students. This strong emphasis on secondary education is apparent even when development spending is taken into account. This is despite the fact that the ESP places just as much emphasis on increasing primary school enrollment as on raising female secondary education. But the expenditure reality is clearly tilted towards secondary education at the expense of primary education—a clear disconnect between sector strategy and expenditure allocation. The inattention to primary education needs to be corrected but not at the expense of secondary education.

20. Poor planning contributes to inefficient expenditures. District governments, despite being legally mandated, barely have any planning function other than paying salaries. Education figures prominently in district governments' non-discretionary spending, but is a neglected item in the discretionary budget. Geographical Information System (GIS) analysis reveals substantial misallocation of resources over the years. GIS analysis of school locations in Swabi district shows that a substantial percentage of schools are located relatively close to each other and a consolidation may be needed. Moreover, while resources have been allocated towards enhancing the education sector horizontally, there is relatively less emphasis on introducing qualitative depth into the sector.

21. Attempts have been made to link budget with outcomes in KP. Despite the introduction of output-based budgeting, the shifts in expenditure have been volatile, in both current and development expenditures. There is no direct linkage with learning outcomes. KP has no mechanism in place to measure learning progress at school and district level, as Punjab's Examination Commission does, so it is difficult to measure how, if at all, the increased spending is improving learning in schools.

22. The failure of increased spending to improve schooling access for boys and girls is a major cause of concern. The recent gains in secondary education, including those for girls, appear to have a very high cost. More nuanced, localized policies are needed to better target specific issues. For example, simply building schools throughout remote districts, with very low enrollment numbers, may not be the right policy. A more sound policy option might be to remove demand-side barriers, such as providing transport subsidies, hostels and other facilities to encourage participation.

The Health Sector

23. KP's health outcomes are mixed. While overall improvement in life expectancy is improving, there is deterioration in few key outcomes such as infant mortality and child nutrition status. Maternal mortality rate has improved, but not at the pace required to meet the MDG by 2015.

24. KP households spend a significant share of their total consumption on health—a much higher proportion than those of other provinces—across all income quintiles. The higher quintiles spend as much as twice that of their counterparts in other provinces. Income differentials are evident in child health service use. Children in low income quintiles had lower immunization coverage and health service use for various illnesses than other income quintiles. They also lived in unhealthier environments. As a result, the poor tend to have worse health outcomes.

25. KP's population tends to prefer public health facilities: 58 percent use government-run facilities instead of those privately run. In KP use of public facilities is much higher than those in other parts of Pakistan, where most people tend to prefer private facilities (an average of 60 percent in 2010). However, for certain services, such as child immunization, most Pakistanis rely on immunization campaigns (58 percent) and government health facilities (24 percent), more than private health facilities.

26. Public sector accounts for only quarter of total health expenditure. The public sector contribution to total health expenditure increased to 25 percent from 18 percent in 2008. More than two-thirds of public health sector expenditure goes towards hospitals. If this pattern is maintained it will likely be at the expense of targeted interventions that are required to improve and meet MDG targets, especially regarding care for mothers and children.

27. The provincial government funds capital expenditure while the district governments handle operating expenses. Most regional hospitals, universities and training institutions receive grants from provincial government, while local government health expenditure goes towards remuneration and other operating expenses.

28. Budget allocation tends to be incremental and not based on desired outcomes. This is a disincentive for performance, which limits free flow of funds to achieve goals and reinforces artificial separation of current and development expenditures.
29. The health sector strategy should be anchored in the provincial MTBF, which should guide health budget allocations and implementation, taking account of the unique characteristics and needs of its districts, and ensure that the budget is aimed at achieving progress in the lagging health indicators.
30. The KP government should aim at implementing public-private partnerships (PPPs) in the provision of health services and facilities. It should expand the coverage of health services by including more functions within the PPP framework.
31. An inter-ministerial coordinating committee should be formed to oversee health service delivery. Such coordination would enhance the effectiveness of government institutions in health service provision, using existing capacity and services more efficiently and effectively.
32. KP needs to draw up a financing plan for the health sector in order to better handle the additional responsibilities accorded to the province under the Seventh NFC Award. This is the time to increase investment in the health sector. The current strategy proposal envisages huge investments with external resources, which may not be a realistic scenario.
33. KP health sector policies should aim to make the sector more results-oriented, with data collection to measure progress. This would require extra fund allocations for monitoring and evaluating results, and linking district financing to performance.
34. High fertility rates and low use of contraceptives are particular problems in KP. A greater proportion of health sector budget should be devoted to rectifying the imbalances in these indicators, as the provision of basic services to a rapidly increasing population will pose even greater challenges for health services in the future.
35. The fact that KP is not on track to achieve the MDG means that Government needs to shift attention and resources to the delivery of basic services in the area of mother and child health. It should address inequalities by increasingly availability and access to basic services in now under-served areas. Health promotion is also needed to address the lagging demand for some essential services.

Chapter 1:

Fiscal Policy, Performance, and Expenditure Trends

1.1 Introduction

Khyber Pakhtunkhwa (KP) is one of the least-developed and crisis-prone provinces in Pakistan. Located in far north of the country, the province covers 10 percent of the total land area and is a home to 13 percent of the country's population spread over seven administrative districts. Majority of the population (83 percent) is rural, averaging 7.6 members per household—well above the national average of 6.6. The literacy rate remains low at 49 percent with more than half of population having no access to tap water while unemployment runs at 8.5 percent. KP's relative underperformance is primarily due to low levels of growth, socio-economic underdevelopment and lack of public services compared to other provinces of Pakistan. It is also prone to militancy, largely due to its proximity to the geo-political conflict in Afghanistan and the vagaries of Mother Nature (catastrophic floods in 2010 and earthquake in 2005)—calling constantly for government and international interventions, and investment to improve the quality of life and unlock its economic potential.

1.2 Cognizant of the growth challenges ahead and acting upon Post Crisis Needs Assessment (PCNA) for KP/Fata carried out by the Government of Pakistan (GoP) in October 2010, a harmonized donor approach was agreed upon to meet the short- and medium-term social and economic needs of the province, one of which, is the establishment of Multi Donor Trust Fund (MDTF). This Public Expenditure Review (PER) of KP province is funded by MDTF and is undertaken in partnership with Government of KP (GoKP) as one of the important outcomes of PCNA.

1.3 This chapter reviews the role of public expenditure and is composed of eight sections. Section 1.2 reviews the social economic environment of KP public finance management; Section 1.3 reviews KP fiscal management; Section 1.4 examines fiscal space and its use; Section 1.5

Box 1.1 Key Messages

- While poverty has declined in Khyber Pakhtunkhwa, one of Pakistan's poorest provinces, social outcome indicators remain weak due to structural deficiencies and policy issues.
- Structural deficiencies in the form of poor governance, weak administration and fragile provincial finances have stunted public-sector efficiency.
- The province relies heavily on federal transfers, leaving little autonomy to decide its own fiscal policy.
- Expenditure on both development and current programs depends on fiscal space, with most current spending devoted to staff hiring that puts pressure on already-high pension and remuneration outlays.
- Government prioritizes economic services but spreads resources too thinly across a large number of activities, thus lowering the share of benefits.

analyzes fiscal and financial management reforms; Section 1.6 looks at challenges and deficiencies that undermine revenue and expenditure effectiveness; Section 1.7 presents evolving expenditure trend; and, finally, Section 1.8 sets out recommendations for fiscal management reform.

1.2 The Economic and Social Environment

1.4 KP is one of Pakistan's poorest provinces and has many structural deficiencies. Locational disadvantage, fallout from international tensions, insufficient investment in human and physical capital, and a policy environment that compounds, rather than alleviates, the ill-effects of these deficiencies have conspired to bring KP to its current economic plight. The average monthly income in the province, Rs 7,709, is the lowest of all four provinces—10 percent lower than the national average and 18 percent lower than Balochistan's (Table 1.1). It is no surprise to find that poverty is widespread in KP, especially in rural areas.

Table 1.1 Household Monthly Income by Provinces and Income Quintiles

| | Average Monthly Household Income (Rs) | | | Share of Income Quintiles in Household Income | | | | |
|--------------------|---------------------------------------|---------|---------|---|------|------|------|------|
| | 2005/06 | 2007/08 | 2010/11 | 1st | 2nd | 3rd | 4th | 5th |
| Punjab | 5,596 | 6,623 | 8,541 | 8.4 | 10.6 | 14.2 | 20.8 | 46.0 |
| Sindh | 5,909 | 7,310 | 8,746 | 8.8 | 13.3 | 15.3 | 21.2 | 41.5 |
| Khyber Pakhtunkhwa | 4,949 | 6,146 | 7,709 | 11.4 | 16.8 | 19.6 | 24.1 | 28.1 |
| Balochistan | 4,938 | 6,441 | 9,439 | 8.8 | 20.4 | 24.3 | 25.4 | 21.1 |
| Pakistan | 5,578 | 6,740 | 8,540 | 8.8 | 12.3 | 15.5 | 21.4 | 42.0 |

Source: Pakistan Bureau of Statistics, 'Pakistan Integrated Economic Surveys', various issues.

1.5 KP's social outcomes are below the national average. This is exemplified in the province's weak achievements in education and health, characterized by high urban-rural and male-female disparities. The literacy rate (10 years and older) was 50 percent in 2011, compared to 58 percent for Pakistan. The infant mortality rate, 63 per 1,000 live births, is high by international standards, but is the lowest in Pakistan which averages 78 per 1,000 births. Estimates of maternal mortality are unavailable but improvements are likely to be modest given the persistence of high fertility, limited changes in the practice of deliveries at home, and the small proportion of births attended by skilled personnel. There is relentless population pressure driven by a fertility rate of 4.3, which is high compared to the national average of 4.1, 3.2 for India and 3.1 for Bangladesh. The contraceptive prevalence rate is 18.7 percent, compared with 21.7 percent nationally and far below the rates for India and Bangladesh. However, 45 percent of households in KP have access to tapped drinking water, compared to 32 percent for Pakistan (Table 1.2).

Table 1.2 Pakistan—Key Social Indicators (Rates, %)

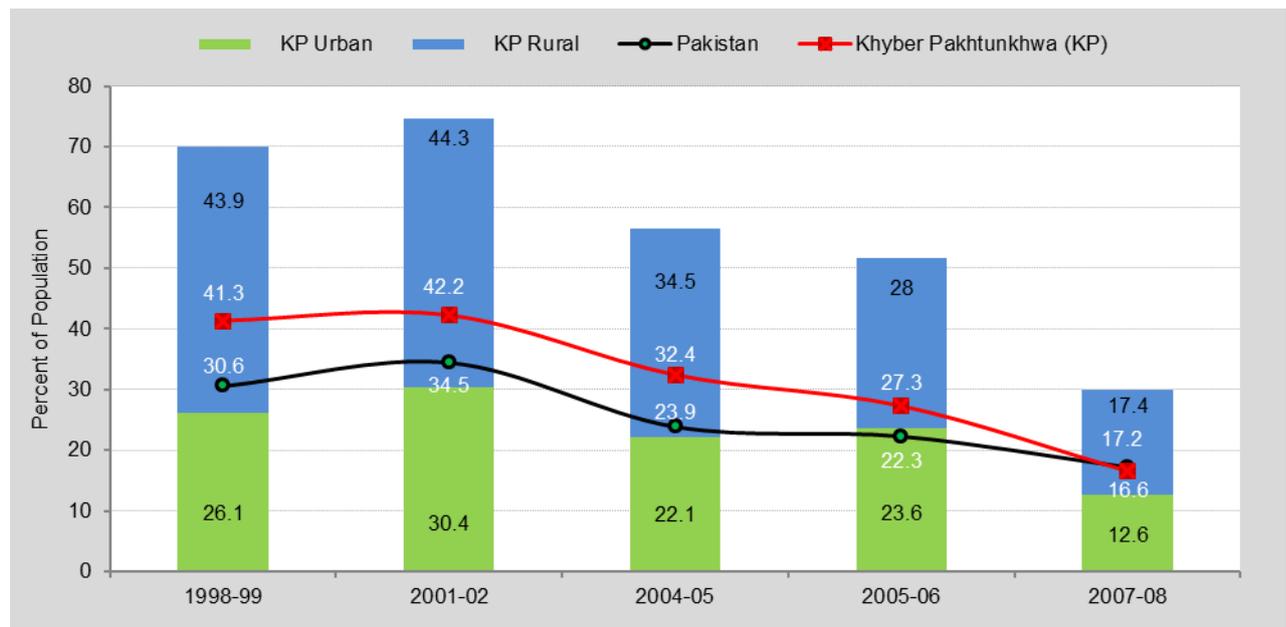
| | Literacy | Gross Enrolment | Infant Mortality | Child Mortality | Tap Water | Fertility | Contraceptive Prevalence* |
|--------------------|----------|-----------------|------------------|-----------------|-----------|-----------|---------------------------|
| Pakistan | 58 | 92 | 78 | 18 | 32 | 4.1 | 21.7 |
| Punjab | 60 | 98 | 81 | 18 | 24 | 3.9 | 23.1 |
| Sindh | 59 | 84 | 81 | 22 | 43 | 4.3 | 22.0 |
| Khyber-Pakhtunkhwa | 50 | 89 | 63 | 13 | 45 | 4.3 | 18.7 |
| Balochistan | 41 | 74 | 49 | 11 | 35 | 4.1 | 13.4 |

Sources: PSLMS 2011 (literacy, enrollment, and tap drinking water); PDHS 2008 (mortality rates, fertility and contraceptive prevalence).

* Defined as percentage of women of child bearing age currently using any "modern" contraceptive.

1.6 There has been an impressive reduction in poverty in both urban and rural areas in KP. This is due mainly to remittances from KP workers who have left the province to work elsewhere because of job shortages at home. These remittances have raised the income of nearly 40 percent of all KP households (HIES 2011). The workers migrate mostly to urban metros of richer provinces, especially Karachi and other countries, mainly in the Gulf. The province experienced a sharp decline in the incidence of poverty from 1999-2008 (Figure 1.1). Notwithstanding this decline, however, the provincial GDP in 2011 was still only 10.5 percent of the national GDP.

Figure 1.1 Poverty Trend in Khyber Pakhtunkhwa and Pakistan



Source: Various issues of Pakistan Poverty Assessment, Government of Pakistan.

1.7 The perilous security situation compounds problems in accessing public services. Social unrest in parts of KP and its adjacent areas is linked to a high concentration of poverty, a lack of investment opportunities and massive underemployment. A Post Crisis Needs Assessment (PCNA) identified poverty and poor access to public services as catalysts to militancy and flagged the two issues as priorities for bringing back stability to rural KP.

1.8 There is low private-sector participation and high dependence on public sector in KP. Poor education and health care contribute to low living standards and their improvement is key to raising the economic prospects of the province. The high incidence of poverty and low private sector participation produce poor social indicators because of inadequate reach and low quality of public service delivery. This in turn points to a weak fiscal resource base and relative inefficiency of government expenditure on physical infrastructure and public services. Yet the pervasive view within the government, and to some extent, the province, is that only the government is able to provide basic services and key infrastructure as well as income and employment in the province. This creates a perpetual cycle in which weaknesses within the public and private sectors reinforce each other.

1.9 There are three constraints on public-sector efficiency. To break this cycle it is important to determine and address the basic constraints on public-sector functions. These constraints can be loosely categorized as (a) inadequacy of laws, rules, procedures and processes governing the running of the government, (b) weak administrative and technical capacity of public sector institutions, and (c) fragility of provincial finances. This review

focuses primarily on the issue of provincial finance fragility while recognizing that the other two constraints have a strong bearing on the management and efficiency of public finances.

1.3 Provincial Finances: Fiscal Prudence and Trends in Fiscal Aggregates

1.10 Fiscal prudence is important. The public finances of KP have remained troubled over the last two decades—a process initiated and exacerbated by imprudent policies of successive governments at federal and provincial levels. KP's fiscal situation experienced a crisis in the mid-1990s, when a faltering economy, falling revenue, ballooning wage and debt-servicing bills, and an unfavorable National Finance Commission (NFC) Award (Box 1.2) converged to impose a tight fiscal squeeze on the province. Expenditure cutbacks necessitated by this adverse fiscal situation, impacted service delivery and development activity, which contributed to a sharp increase in poverty and stagnation of social indicators. Better economic performance in the mid-2000s, along with favorable changes to the revenue sharing formula, arrested the decline in provincial finances (Table 1.3), but the desired improvement remained elusive.

Table 1.3 Fiscal Accounts of Khyber-Pakhtunkhwa, 1990-91 to 2010-11

| | 1990/91 | 1995/96 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total Revenues | 8.1 | 8.6 | 8.0 | 7.0 | 7.8 | 7.0 | 8.7 | 11.3 |
| Tax and Non-Tax Transfers | 6.8 | 7.8 | 7.3 | 6.5 | 7.3 | 6.5 | 8.3 | 10.4 |
| Provincial Revenues | 1.3 | 0.8 | 0.7 | 0.5 | 0.5 | 0.5 | 0.4 | 0.8 |
| Tax Revenues | 0.3 | 0.3 | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 |
| Non-Tax Revenues | 1.0 | 0.5 | 0.5 | 0.3 | 0.3 | 0.3 | 0.2 | 0.7 |
| Total Expenditure | 11.2 | 10.1 | 9.7 | 8.6 | 8.8 | 8.1 | 9.7 | 10.6 |
| Current Expenditures | 8.1 | 8.1 | 7.4 | 5.8 | 5.9 | 5.7 | 7.0 | 7.6 |
| General Administration | 0.7 | 1.0 | 0.6 | 0.7 | 0.7 | 0.8 | 0.7 | 0.6 |
| Law & Order | 0.7 | 0.6 | 0.7 | 0.6 | 0.8 | 0.8 | 1.4 | 1.2 |
| Community Services | 0.5 | 0.4 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Social Services | 2.7 | 2.7 | 4.1 | 2.6 | 2.7 | 2.7 | 2.9 | 3.1 |
| Economic Services | 0.9 | 1.1 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 1.0 |
| Subsidies | 0.4 | 0.3 | 0.1 | 0.1 | 0.2 | 0.2 | 0.1 | 0.1 |
| Debt Servicing | 2.3 | 2.0 | 0.9 | 0.8 | 0.6 | 0.5 | 0.4 | 0.3 |
| Grants | 0.0 | 0.0 | 0.2 | 0.3 | 0.3 | 0.1 | 0.8 | 0.6 |
| Others | 0.0 | 0.0 | 0.3 | 0.0 | 0.0 | 0.0 | 0.0 | 0.4 |
| Development Expenditure | 3.1 | 2.0 | 2.2 | 2.8 | 2.9 | 2.5 | 2.8 | 3.0 |
| Revenue Surplus (+)/Deficit(-) | 0.0 | 0.5 | 0.6 | 1.3 | 1.9 | 1.3 | 1.7 | 3.7 |
| Fiscal Deficit | -3.1 | -1.4 | -1.7 | -1.5 | -1.1 | -1.1 | -1.1 | 0.7 |

Source: Finance Department, Government of Khyber Pakhtunkhwa and World Bank Staff calculations.

Box 1 The implications of 7th NFC Award

After a delay of over two years, the federal and provincial governments have agreed on a new (Seventh) NFC Award. The new Award has raised the share of provinces in the divisible pool of federally collected taxes from 46.25 percent to 56 percent. However, under the Sixth NFC Award, the provinces also used to get additional revenue collected from the 1997 increase in rate of GST from 12.5 percent to 15 percent. Under the new NFC Award, this additional transfer of GST revenue was withdrawn. Furthermore the size of the divisible pool has been somewhat expanded by reducing the collection charges retained by the federal government from an average of 5.2 percent to only 1 percent.

For horizontal distribution of revenue among provinces, the Seventh NFC Award has moved away from the past practice of using population share as the sole criteria and has included other factors, such as poverty/backwardness, tax collection and geographical size (along with population share), in the formula. The new Award has made a specific attempt to cater to the needs of the two smaller provinces. Over the last few years, natural gas-related revenue transfers, especially to Balochistan, have declined substantially, leaving a huge resource gap in the provincial budget. To cover this gap, the new Award has significantly increased the share of Balochistan in the divisible pool. The shares of all other provinces were reduced. Nevertheless, to help KP cover the cost imposed by the 'war on terror', 1 percent of gross revenue from the divisible pool will be provided to the province as direct transfer. At the same time, all federal grants and subventions have been discontinued and rolled into the divisible pool, as is the case with revenue transfers from the increased rate of GST. The new Award is expected to transfer a significantly higher overall level of fiscal resources to the provinces. The following table provides tentative calculations of the fiscal impact of the NFC Award on the fiscal position of provincial governments, KP in particular.

Box Table 1.2.1 Tentative Projections of Federal Transfer to Provinces Under 7th NFC Award

| | 2009-10 (Benchmark) | 2010-11 (1st year) | 2011-12 (2nd year) | 2012-13 (3rd year) | 2013-14 (4th year) | 2014-15 (5th year) |
|---|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <i>Projection of Transfers to all Provinces</i> | | | | | | |
| Federal Receipts | 1,988 | 2,328 | 2,725 | 3,138 | 3,652 | 4,224 |
| FBR Revenues | 1,380 | 1,550 | 1,952 | 2,329 | 2,758 | 3,232 |
| Surcharges | 134 | 132 | 146 | 146 | 146 | 146 |
| Non-tax receipts | 475 | 495 | 530 | 550 | 615 | 691 |
| Divisible Pool Gross | 1,266 | 1,473 | 1,855 | 2,213 | 2,620 | 3,070 |
| 1% to KP for war on terror | - | 15 | 19 | 22 | 26 | 31 |
| Divisible Pool Net (after subtracting 1% for War on Terror) | 1,266 | 1,458 | 1,836 | 2,191 | 2,594 | 3,040 |
| <i>Provincial Share in the Div Pool</i> | 45.00% | 56.10% | 57.50% | 57.50% | 57.50% | 57.50% |
| Provincial Share in the Div Pool | - | - | - | - | - | - |
| Grants in Aid (Special Grant) | 47 | - | - | - | - | - |
| Total | 47 | - | - | - | - | - |
| Straight Transfers | 68 | 129 | 147 | 167 | 190 | 216 |
| <i>out of which GST on Services</i> | - | 51 | 61 | 73 | 87 | 102 |
| Total Federal Transfers incl. war on terror transfers | 115 | 144 | 166 | 190 | 217 | 246 |
| <i>Projection of Transfers to KP</i> | | | | | | |
| Divisible Pool Transfers | 185 | 215 | 271 | 323 | 383 | 449 |
| 1% Of Gross Divisible Pool (for war on terror) | - | 15 | 19 | 22 | 26 | 31 |
| Straight Transfers to KP | 3,999 | 24 | 28 | 31 | 36 | 41 |
| Total Transfers to KP | 4,184 | 254 | 318 | 377 | 445 | 521 |

Source: WB staff calculations

1.11 Resource inflow has improved the fiscal stance, resulting in a surplus. Over the last two years, provincial finances have markedly improved. This is mainly due to increased revenue transfers from the federal government through the payment of arrears from hydel power profits and a new NFC Award (Box 1.2). This sharply raised the provinces' share of federal revenue. KP's total revenue, which had been hovering around 7-8 percent of Provincial Gross Domestic Product (PGDP)³, increased to 8.7 percent in 2010 and 11.3 percent in 2011. This prompted the provincial government to increase its expenditure, with sharp increases in both current and development spending.

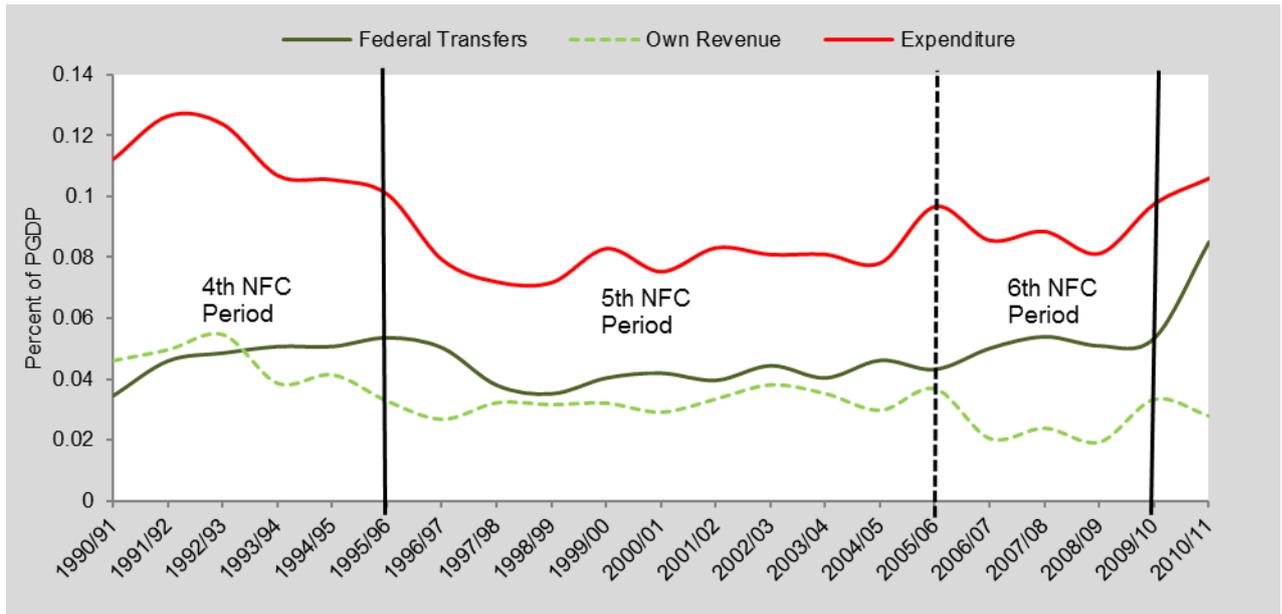
1.12 Even before the recent improvement, provincial finances appeared to be well managed, at least with regard to budgetary deficit. From 1998-2004, when provincial finances were under tremendous pressure, the deficit never exceeded 2 percent of PGDP, and the overall debt of the province declined over time while composition improved.

1.13 Low fiscal deficits occur more by default than design. In Pakistan it is not appropriate to gauge the adequacy of provincial finances by looking solely at fiscal deficits. This is because, until recently, the provincial governments were constitutionally compelled to borrow only from the federal government or with its expressed consent. Therefore, provincial expenditure is constrained by the availability of revenue and donor assistance, and this depends more on the federal government's foreign exchange requirements than on the province's developmental and fiscal needs. The role of provincial governments in running-up fiscal deficits is restricted to small amounts that might be financed from a build-up of deferred liabilities (e.g. utilization of provident fund monies), borrowing from provincial autonomous bodies, or by drawing down provincial cash balances, if any. Any shortfall in revenue from the planned level generally has been met by scaling back provincial expenditure, thereby weakening the quantity and quality of public services delivered by those governments.

1.14 Provincial expenditure is dependent on federal revenue transfers that leave little room for fiscal policy freedom. The fiscal crisis in Khyber Pakhtunkhwa in the mid-1990s was due mainly to a shortfall in revenues from both the federal government and its own sources. The Fourth NFC Award, announced in 1990, increased federal transfers to the province and kept them fairly stable. However, own-source revenues of the province plummeted, partly because the economy slowed but mainly because of inappropriate policies of the government. While increasing federal transfers, the Fourth NFC Award discontinued most federal grants to the provinces, including the revenue deficit grant, thus depriving them of their main source of finance for their fiscal deficits. Donor financing was available to provinces but only in small measure. This forced the provinces to sharply cut back on expenditure in order to reduce their deficits (Figure 1.2). The Fifth NFC Award, in 1996, delivered another blow to provincial finances as it distributed all tax and other major federal revenues to the federal and provincial governments on a fixed-share basis. Prior to this award, the provinces had enjoyed an 80 percent share in more buoyant taxes (i.e. income and sales taxes) while the federal government retained most of the excise duties and all customs duty revenues—taxes with declining revenues. In addition, immediately after the award, the federal government introduced far-reaching tariff reforms which drastically reduced the rates of customs tariffs and lowered the General Sales Tax (GST) from 15 percent to 12.5 percent. This brought a sharp decline in federal transfers, forcing further cutbacks in provincial expenditure. The Sixth NFC, in July 2000, failed to find consensus on a revenue-sharing formula, and thus no award could be announced. In 2006, however, a Presidential Order made changes to the Fifth NFC Award formula, which significantly enhanced the share of provinces in federal revenue. As has generally been the case in Pakistan, the increased federal transfers brought a decline in provincial revenue, with hardly any increase in provincial expenditure. In 2009, the Arbitration Commission awarded the KP government Rs 110 billion in arrears of hydel profits (to be paid by the federal government over five years) and in 2010, the Seventh NFC Award substantially increased the provincial share, and gave 1 percent of divisible revenue to KP to meet the cost of 'war on terror'. This boosted the provincial resources and therefore expenditures.

³ Provincial GDP estimates. See Annex 1 for methodology of PGDP calculation.

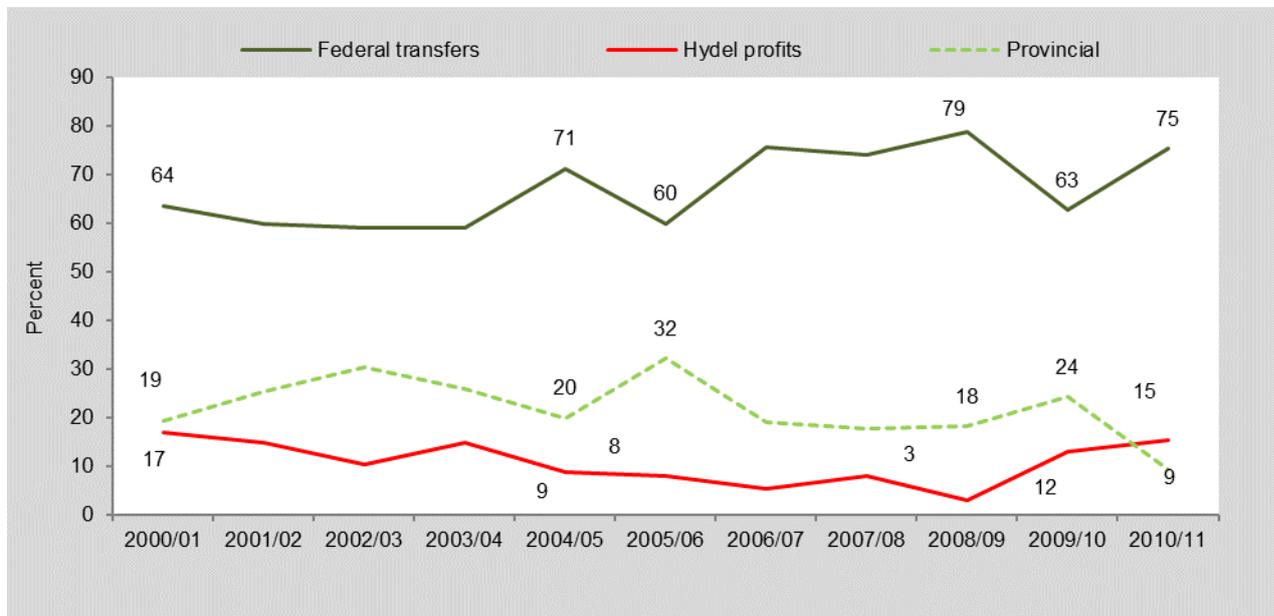
Figure 1.2 Khyber Pakhtunkhwa: Trends in Revenue and Expenditure



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration

1.15 The assignment of tax revenues to the provinces presents a picture of absolute dependence on federal government. As indicated above, KP remains heavily dependent on revenue transfers from federal government⁴. In terms of revenue assignment, Pakistan appears more as a unitary government than a federation. The fiscal autonomy of KP (and indeed of all provinces) is restricted by a tax assignment in which all broad-based and buoyant taxes go to the federal government, with provinces having control over only a few small and generally inelastic taxes (Figure 1.3).

Figure 1.3 Khyber Pakhtunkhwa—Current Receipts (% of Total Receipts)



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration

⁴ Federal transfers, hydrel profits and royalties made up 93 percent of KP's total receipts in 2010-11.

1.16 Provincial tax collection is about 2 percent and declining. Provincial tax collection in 2010-11 was 2 percent of total current receipts—a fall from 5 percent in 2000-01. There has been no change in the composition of revenue collection by sources (taxes make up 65 percent of the total with the rest non-tax) in the past decade due to high dependence on receipt transfer from the center and government's reluctance to undertake any tax reforms. The non-buoyant provincial tax base and near-total reliance on federal transfers make provincial governments extremely vulnerable to adverse revenue shocks.

1.17 Federal transfer volatility affects expenditure level and flow. Overall, provincially collected revenues used to finance less than 20 percent of the KP government's expenditure. In recent years, this ratio has dropped to about 6 percent. With most of provincial government's expenditure being financed by federal transfers, the provincial government's fiscal position has remained vulnerable to changes in federal tax policy and revenue collection. Due to weak tax collection machinery and inappropriate phasing of tax and tariff reforms⁵, federal revenue collection has remained uncertain, volatile and generally inadequate. The absolute dependence of provinces on these transfers implies that large shortfalls in federal revenue collection cannot be absorbed through fiscal adjustments at provincial level and therefore are likely to have a distressing impact on KP government's finances.

1.18 The provincial governments' satisfaction with federal transfers has undermined efforts to reform the tax system which would raise taxes on the voting population. Provinces' own revenue mobilization has been weak and little effort is made by the provincial government to collect revenue from its assigned bases. This is partly due to the evolution of intergovernmental fiscal relationships in Pakistan, whereby the federal government manages a very large portion of revenue collected in the country and then caters to the expenditure needs of the provinces either through revenue transfers or discretionary grants. On the other hand, the provincial governments are generally satisfied with this arrangement as they are spared the political cost of imposing additional tax burden on the voting population. As such, increases in intergovernmental transfers from the center have been large enough to allow a slowing of effort exerted to collect provincial taxes.

1.4 Creation and Utilization of Fiscal Space

1.19 The government's ability to achieve its goals depends upon the fiscal space available for it to implement its development priorities. There is no perfect definition of fiscal space, but it is clear that revenue mobilization is probably the most important way to create additional fiscal space. Better expenditure management would also help, as it could enable the government to reduce non-essential public spending (i.e. by rationalizing or scaling back non-essential functions) and at the same time improve the efficiency and effectiveness of expenditures that would achieve better economic and social outputs and outcomes. In order to analyze KP government's performance in this regard, we define fiscal space as the gap between the level of total fiscal resources available (revenue and borrowing) to the government and its expenditure commitments, such as wages, pensions and debt interest⁶.

1.20 The KP province's fiscal space currently amounts to 3.5 percent of PGDP. In five years from 2002 to 2006, additional fiscal space of 1.9 percent of PGDP became available to the KP government. This space came from three main sources: federal revenue transfers (1.7 percent of PGDP), provincial own-source revenues (1.5 percent) and from running higher fiscal deficits (0.4 percent). The fiscal space was constricted, however, by a high wage and pension bill (that absorbed 1.5 percent of PGDP) and interest payments (that absorbed 0.2 percent) (Figure 1.4, left panel).

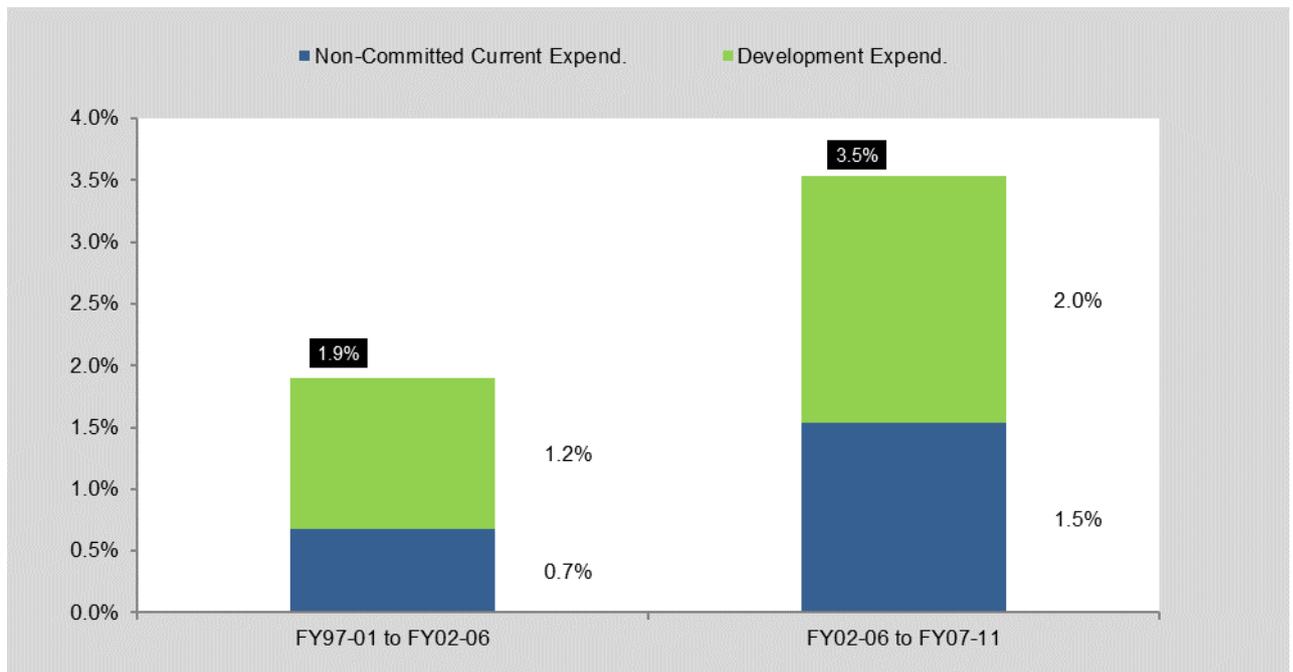
⁵ In the early 1990s, Pakistan embarked on ambitious tax and tariff reforms in which customs duties were slashed drastically, leading to significant loss of revenue from import-related taxes. The shortfall was to be covered by strengthening direct and sales taxes. However, for political and administrative reasons the reforms took time to kick in, and so Pakistan witnessed a dramatic slowing in revenue collection in the mid-1990s.

⁶ By this definition, fiscal space is the level of non-committed expenditure of the government.

1.21 In the next five-year period (2007-11) further fiscal space amounting to 3.5 percent of PGDP became available to the provincial government. The sourcing of this space, however, was quite different to that of the previous five years: increased federal transfers contributed 4.1 percent of PGDP and provincial own-source revenue contributed another 1.0 percent, and improved debt management by the provincial government led to savings on interest payments, which contributed an additional 0.1 percent of PGDP. The total was again undermined by increased employment levels and higher salaries of government employees (absorbing 2.0 percent of PGDP), and lower fiscal deficits (absorbing 0.3 percent of PGDP). As in the previous period, higher wage and pension bill has sliced away a significant portion of resources. In this regard, government should make an effort to estimate future liabilities of current employment policies to project its impact on future fiscal space and its impact on development priorities and make decisions accordingly.

1.22 More of available fiscal space is going towards development expenditures. The use pattern of this additional fiscal space was shifting towards development expenditures in the two periods. Development expenditures which were occupying 37 percent of available fiscal space in first period moved to 43 percent in second period.

Figure 1.4 Additional Fiscal Space and Usage



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration.

1.5 The Fiscal and Financial Management Reforms Undertaken by the Province to Enhance Fiscal Space

1.23 Fiscal reforms are underway to sustain public finances. Since 2000-01, the provincial government has been pursuing a comprehensive reform agenda to accelerate economic and social development in the province. To achieve its development objectives, the government has taken a number of steps to ensure that there is significant fiscal space available to finance its key initiatives.

1.24 With a view to strengthening all aspects of public finances, the KP province adopted a comprehensive fiscal reform program in 2001-02 with the overarching objective of maintaining a sustainable fiscal position and improving provision of public services. The reforms have focused on the following four key areas of public finance: (i) enhancing

revenue; (ii) reprioritizing expenditures and improving expenditure management; (iii) improving budget preparation, execution and oversight; and, (iv) strengthening the bounds of fiscal decentralization. These reforms are continuing, with a revised focus over last three years.

Enhancing Revenue

1.25 Ensuring greater revenue transfers: The province intensified efforts to get its due share of federal revenue transfers and the hydel profits. The Seventh NFC Award concurred with KP's position that as a frontline province in the 'war against terror', the costs of its efforts in this regard should be shared by all the governments, not just KP on its own. The award, therefore, included a 1 percent (of the gross divisible pool) additional revenue transfer to KP. For the same reason, the KP government sought grants, rather than loans, in assistance from the international donor community. This raised foreign grants to KP from Rs 1.5 billion in 2008-09 to Rs 14.7 billion in 2009-10. Similarly, while the 1990 NFC Award agreed that profits from hydel electricity would be provided to the province where the power station was located, owing to the precarious financial health of the Water and Power Development Authority (WAPDA), the federal government agreed to cap the transfer of hydel generation profits at Rs 6 billion per annum. The KP governments won a favorable verdict in this regard from the arbitration commission to uncap this limit and started receiving arrears in this regard.

1.26 Streamlining of provincial own-source revenue: The provincial government took some steps to restructure its tax system. Analytical studies were commissioned to better understand the options for tax policy and administration.⁷ Revenue mobilization was strengthened through tax restructuring, rationalizing user charges and improving tax administration. Tax reforms included (a) reducing the number of provincial taxes (from 23 to 6) by eliminating small, nuisance taxes, (b) imposing an agricultural income tax (AIT) to complement the province's land-based tax and (c) harmonizing Agriculture Income Tax (AIT) and Motor Vehicle Tax (MVT) rates with those of other provinces. User charges were raised for tertiary-level social services and irrigation water. Tax administration measures included (a) opening a privately-operated Tax Facilitation Center (TFCs) for collection of Motor Vehicle and property taxes in major urban centers, (b) piloting the computerization of land records, (c) setting up a school for patwaris and training of Board of Revenue staff, (d) instituting performance-based monetary incentives for revenue staff, and (e) returning aabiana collections (irrigation water charges) to the Irrigation Department.

Reprioritizing and Improving Provincial Expenditure Management

1.27 Expenditure management has been strengthened and expenditure composition has improved through reprioritization. Some key measures are highlighted below:

- Provincial Debt Management Strategy: The province has pursued a sensible debt management strategy. In order to create additional space in its budget. The provincial government has used donor funds (received from program assistance or as grants) to prematurely retire much more expensive federal cash development loans. From 2002-03 to 2007-08, the provincial government prematurely retired Rs 15.8 billion of the federal government's most expensive debt. This created additional fiscal space of Rs 3.4 billion per annum (Table 1.4). Taking advantage of a large fiscal surplus generated in 2010-11, mainly because of additional NFC transfers, the provincial government retired additional federal loans of Rs 4.0 billion, yielding an additional saving of Rs 1.0 billion per annum.

⁷ These studies included the Reform of Agriculture Income Tax (AIT) and Land Tax in NWFP (2003), Tax Potential in NWFP (2004) and Reform of Tax Administration in NWFP (2004).

Table 1.4 Savings from Early Debt Retirement

| <i>(Rs Million)</i> | | | |
|---------------------|----------------|------------------|----------------|
| | Amount retired | Average interest | Annual savings |
| 2002/03 | 5,687 | 17.4% | 1,075 |
| 2003/04 | 1,992 | 15.9% | 384 |
| 2004/05 | 2,457 | 15.0% | 449 |
| 2005/06 | 0 | -- | 0 |
| 2006/07 | 2,749 | 14.6% | 872 |
| 2007/08 | 2,953 | 15.7% | 627 |
| 208/09 | 0 | -- | 0 |
| 2009/10 | 0 | -- | 0 |
| 2010/11 | 4,037 | 25.4% | 1,028 |
| Total | 19,875 | -- | 4,435 |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration

- **Rationalizing Other Expenditures:** The provincial government reduced the untargeted wheat subsidy from Rs 3.3 billion in 2000-01 to Rs 500 million by 2006-07. However, with an increase in procurement price of wheat the wheat subsidy increased again, to over Rs 2 billion since 2008-09, and the trend continues. On positive side, the government has closed a number of public enterprises and autonomous bodies, saving Rs 70-100 million on annual basis.
- **Managing Pensions and Provident Funds:** The province in the past used General Provident Fund (GP Fund) money to finance its expenditure. The provident fund payments are made from the budget. Similarly, pension payments of the province have been increasing at an exponential rate. These two payments impose an additional burden on the budget. Realizing the unsustainable nature of this arrangement, the province established a General Provident Investment Fund (GPIF) in 1991-92, aiming to use budgetary resources to recapitalize the provident fund. The GPIF is to be professionally managed to make profitable investments, with profits ploughed back into the fund for faster re-capitalization. The objective is to have the fund capitalized sufficiently to enable the government to take over the provident fund payments of the budget. To oversee the affairs of the fund, a Fund Management Board, under chairmanship of the Chief Secretary of Khyber Pakhtunkhwa, was established. The fund is governed by an Act with specific rules of business for running its affairs. Moreover, the Finance Secretary heads the investment committee, which was constituted to carry out the day-to-day functions of the fund. Its capitalization at the end of June 2011 was Rs 14.2 billion (government contributions totaling Rs 4.8 billion and profit amounting to Rs 9.5 billion—Table 1.5).

Table 1.5 Financial Position of the Provincial GP Fund

| <i>(Rs Million)</i> | | | | |
|----------------------|-----------------|--------------------------|-------------------------|--------------------|
| | Opening balance | Released during the year | Profits during the year | Cumulative balance |
| Till 30.06.06 | -- | 2,750 | 4,341 | 7,091 |
| 2006-07 | 7,091 | 300 | 785 | 8,176 |
| 2007-08 | 8,176 | 300 | 784 | 9,260 |
| 2008-09 | 9,260 | 300 | 947 | 10,506 |
| 2009-10 | 10,506 | 300 | 1,118 | 11,924 |
| 2010-11 | 11,924 | 800 | 1,492 | 14,216 |
| Grand Total | -- | 4,750 | 9,466 | -- |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration

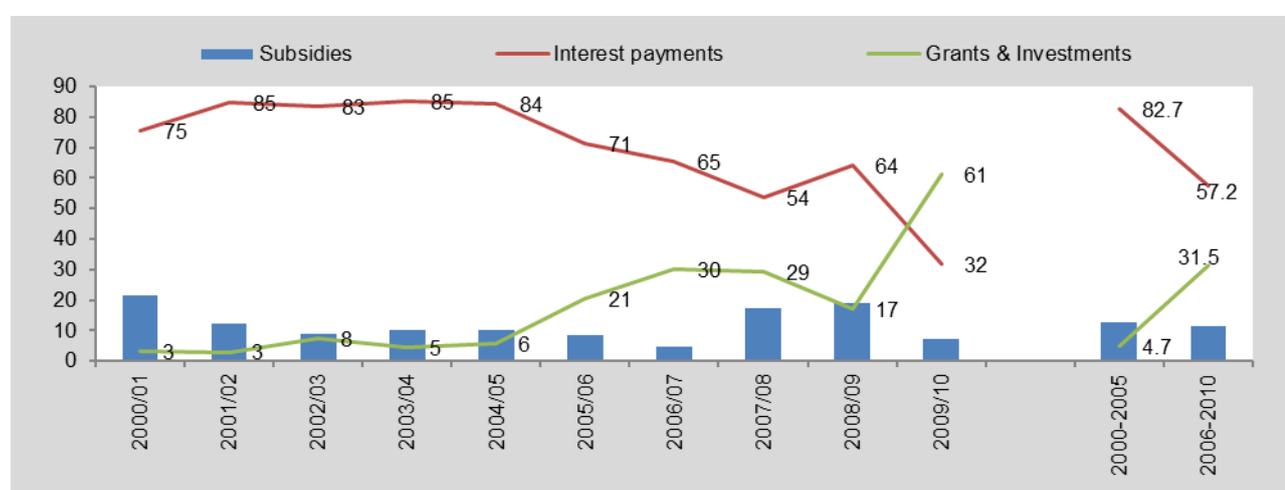
- The Pension Fund was established in 1997-98 with an initial allocation of Rs 150 million from budget. The Chief Secretary heads the management board that looks after this fund. By June 30, 2011, the Pension Fund had increased to Rs 9.1 billion (government contribution totaling Rs 4.6 billion and profit of Rs 4.5 billion—Table 1.6). However, looking at the steep expected growth in pension liabilities, this looks inadequate. Provincial government may want to inject additional money in pension funds using some of available fiscal space to be able to keep a significant part of liability off budget in future.

Table 1.6 Financial Position of the Pension Fund*(Rs Million)*

| | Opening | Released | Profits | Cumulative |
|--------------------|---------|-----------------|-----------------|------------|
| | Balance | During the Year | During the Year | Balance |
| Till 30.6.06 | -- | 2,650 | 1,419 | 4,069 |
| 2006-07 | 4,069 | 400 | 457 | 4,926 |
| 2007-08 | 4,926 | 400 | 389 | 5,715 |
| 2008-09 | 5,715 | 400 | 564 | 6,679 |
| 2009-10 | 6,679 | 400 | 728 | 7,807 |
| 2010-11 | 7,807 | 300 | 990 | 9,096 |
| Grand Total | -- | 4,550 | 4,546 | -- |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff elaboration

- Transfer expenditure⁸ is declining in relation to total expenditure. Transfers were 10.5 percent of total expenditure during latter half of the decade compared to 21 percent in the period 2000-05. Decline in interest payments, from 17 percent of total expenditure in 2000-05 to just 6 percent in 2006-10 contributed significantly to this improvement (Figure 1.5). By retiring high interest-bearing debt in the last few years, interest payments in 2010-11 amounted to 32 percent of Transfer sub-sector expenditure, far below 84 percent in 2005-06. Lower interest payments have been replaced by increased spending on grants, to 61 percent of the Transfer sub-sector expenditure in 2010-11, from a low of 6 percent in 2005-06.

Figure 1.5 Transfer Subsector (as % of Sector Total)

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

⁸ Transfers include subsidies, interest payments, grants and net lending.

Improving Budget Preparation, Execution and Oversight

1.28 The provincial government has instituted several reforms in the preparation, processing and execution of budget with support from DFID. One key reform is the preparation of Medium Term Budgetary Framework and output-based budgeting. The Medium Term Budgetary Framework (MTBF) is an approach to budgeting which links the spending plans of government to its policy objectives. The main feature of a MTBF is that annual budget preparation is carried out within a framework which takes into account the resources expected to be available to the government over the medium term. This is a very bold initiative and would go a long way in reforming the way budget is prepared. Other initiatives include: (a) rolling out Output-based budgeting (OBB) in all line departments; (b) introducing economic classification of expenditures in the budget documents; (c) initiating computerization of land records on a pilot basis; (d) online linking of the provincial and district budgets to enable better consolidation and closer monitoring of budget releases; (e) establishing a professionally staffed budget analysis unit to track and report key fiscal indicators quarterly; and, (f) piloting conditional grants system to improve service delivery in health and education as pilot in two districts. For a brief description of some of these reform initiatives, see Annex 2 and Annex 3.

Fiscal Decentralization

1.29 KP was one of the first provinces to use a needs-based formula (based on population and indicators of social development and backwardness) for budgetary transfers to the districts, starting in 2001-02. All non-salary recurrent expenditures and a significant portion of district development spending were devolved to the districts from 2002-03. The Provincial Finance Commission (PFC) Awards of 2003-04, 2004-05 and 2005-06 continued to strengthen fiscal devolution. These awards provided matching incentive grants to district governments for additional revenue mobilization, allowed districts to retain user charges in health and education, and provided matching grants for collecting revenues over the targeted amounts, provided matching grants for O&M in the roads sector and recommended that 40 percent of the district development funds be used for projects above Rs 5 million in roads and WS&S sectors. The awards enhanced non-salary allocations of districts (by 10 percent in 2003-04 and 25 percent in 2004-05 and 2005-06), directly transferred the Octroi and Zilla Tax replacement grants to Tehsils Municipal Administrations (TMAs), instead of passing them through the districts to ensure timely transfer of funds, and increased it by 10 percent in both 2004-05 and 2005-06. However, with the lapse in 2008 of the Local Government Ordinance (LGO) of 2001, much of the decentralization has reversed. As recently as May 2012, the KP assembly unanimously passed a local governance bill to replace the LGO of 2001. The legislation was approved very recently by provincial legislative assembly and is bound to have a substantial impact on the way services are delivered at district level. For example, the Provincial Finance Commission which allocates resources between the province and district will have a less role, and most of planning and development functions will revert to the province. In effect, these legislative changes are likely to formalize the de facto provincial role in managing education services post-2008, as was the case before 2001. In a way, while roles and functions are decentralized from federal government to provinces through 18th Amendment, provincial legislation would be tantamount to a re-concentration of power to provincial authorities away from districts.

1.6 Challenges and Deficiencies Undermining Revenue and Expenditure Effectiveness

1.30 Fiscal reforms are an ongoing endeavor. KP has come a long way in improving its PFM system so as to cater to its stake holders. Yet, there are challenges that need to be tackled. Following are few of these which may require continuous effort and focus in future.

Challenges in Revenue Management

1.31 Lack of sound fiscal policy: The provincial tax structure is not based on sound tax design. The tax system at present has an exclusive revenue focus. Taxes are imposed only when growing expenditure needs leave the government with no option but to impose new taxes or raise rates of existing taxes. Little or no importance is given to the incidence, equity or efficiency of these taxes.

1.32 Fragmented civil administration: KP has a peculiar administrative structure by which different areas of the province are governed under different administrative arrangements and rules. The provincial government's writ is limited to settled areas only, with tribal areas remaining largely outside its jurisdiction. Different tax administrations and tax regimes apply in different areas. Tribal areas are more lightly taxed than settled areas, which complicates tax collection, even in settled areas. For example, motor vehicle tax is not levied in tribal areas, which has led to a large number of vehicles being registered in tribal areas. These vehicles use provincial roads but pay no tax.

1.33 Inappropriateness and complexity of tax structure: The myriad of taxes clouds the transparency of the tax system and adds to administrative costs, as scarce resources are allocated to pursue what can only be termed nuisance taxes. Some of the bigger taxes, such as stamp duties, are direct levies on economic activity and inputs rather than on income or consumption, thereby discouraging expansion and economic activity in the province. The tax structure is unsuited to enhancing any significant revenue increases relative to GDP, because it is partly based on specific rates, and the provincial government is not taking discretionary action to increase the effective rate of tax collection, such as revaluing property or increasing nominal tax rates. The growth in tax revenues might have slowed because some faster-growing components of the tax base are not taxed or are given exemption or preferential treatment—e.g. owner-occupied property, industrial property and vacant land, and the consumption of services. The complexity of the taxation system inhibits tax compliance and encourages corruption.

1.34 Weak tax administration: Provincial taxable capacity is low and the tax base is hard to reach. One major factor undermining the province's capacity to better manage its taxes is fragmentation of provincial tax administration. It is split into two separate departments: (i) the Excise and Taxation Department (E&T), entrusted with administration of roughly nine major and some minor provincial taxes and enforcement of prohibitions on liquor and drugs; and, (ii) the Provincial Board of Revenue (BOR), responsible for assessment and collection of land revenue, local rates, development cess and other land charges. The BOR also collects water charges and supervises the administration of stamp duties and registration fees which are assessed and collected by another department. Most of the provincial taxes are regulated by an obsolete legal framework which was devised prior to independence and has been only slightly modified to respond to immediate exigencies. The land and property records and assessment schedules are outdated and inaccessible to the general public, which has to rely on the discretion of the lowest revenue official (the excise and taxation officer [ETO] or patwari) to determine tax liability. These persons for the most part lack formal training and apparently in many cases use their discretionary powers for rent seeking rather than providing service to the population or collecting revenues. Provincial tax officials in general are poorly trained and have low motivation. Although there is an intricate supervisory network above the lowest revenue staff, actual supervision is very weak; records are either nonexistent or faulty; and, there is no attempt to verify the information supplied by the revenue official or taxpayer. The district administration, which is supposed to play a critical role in supervising and overseeing the revenue administration and attending to public grievances, has other priorities given the wide functions entrusted to it.

Challenges in Expenditure Management

1.35 Procedural and structural rigidities weaken expenditure effectiveness: On expenditure side, KP has built-in rigidities in its expenditure structure, with establishment costs, debt servicing and other transfer payments preempting a large portion of the budget. Irrational classification of the budget into a variety of components

compromises the efficiency of public spending and introduces avoidable rigidities in provincial expenditure. The recurrent budget is divided into Permanent and New (or SNE) components. The Permanent budget, which finances ongoing activities of the government, is more or less automatic, with hardly any review undertaken of the rationality or even desirability of activities being financed.

1.36 The budget is prepared on an incremental basis, without strategy: Despite some notable improvements such as MTBF and OBBs in the last two years, including preparation of the Budget Strategy Paper, allocations for a large portion of budgetary expenditure continues to be more or less incremental and lacking any clear strategy. Resource allocation and use are not regulated by political and operational objectives. In absence of any strategy, allocations are made on notionally determined limits for increments over the benchmark (usually the estimated actual expenditure of the preceding year). This system of incremental budgeting has promoted a tendency for departments to make initially-inflated demands, irrespective of the strategic importance, or lack thereof, for a budgeted activity. As a result, efficient and inefficient activities get equal treatment and obsolete activities may continue for years, due to systemic inertia. Provincial government's initiatives on MTBF and OBB that address this issue are steps in right direction.

1.37 Strengthening of PFM in line department: Line Departments have the primary role in ensuring that services are delivered to people in the most efficient, economical and effective manner. Unfortunately, service delivery departments have not emerged as recipients of PFM reform interventions in distant past. These line departments have been kept away from PFM related activities for so long that their planning, budgeting and accounting functions have almost atrophied. Resultantly, the PFM reforms have not yet translated into service delivery improvements. Though, implementation of MTBF in line departments is a step in right direction there is still a long way to go in achieving desirable outcomes.

1.38 As mentioned above, existing budget process in line departments is largely an activity of compiling expenditure estimates based on incremental approach. Line departments have two separate sections one each for current and development budget. Preparation of current and development budget at line departments are distinct activities and lack coherence. Therefore overall department budget may not be aligned to achieve the intended policy objectives. Strategy formulation and monitoring of results are also typically weak in line departments. National FMIS connectivity has been extended to the line departments so they can monitor their financial performance but the use of the system is very limited.

1.39 The new reform puts the ball in the court of line departments but they would need appropriate financial management capacity. The fact that the success of all reform initiatives hinges on the capacity of line departments to take on a more proactive role in the Public Financial Management, makes it the focus for all future PFM reforms. The existing budget sections in key line departments may be reorganized into FM units with the responsibility of planning, budgeting and financial reporting. However while doing this it must be considered that no PFM reform in KP can be successful without full ownership and participation of the Finance Department. Therefore, for any PFM initiative in the line departments to succeed, the role of the Finance Department will remain critical.

1.40 The dependence of provincial governments on Federal Government on most aspects of fiscal management and PFM also complicates the issue. Predictability of resource transfers to line department depends upon timeliness of fiscal transfers from the federal government. Audit and Accounts remains a function which is largely administered by Federal entities. At times, decisions taken by the Federal Government impact the provinces. For example, the Federal Government announces increase in salaries of government servants without consulting provincial governments; this makes it difficult for the provinces not to follow the salary structure of the Federal Government. During the last three years, Federal Government increased the salaries of its employees by 100 percent—this decision was reluctantly adopted by all the provinces. Therefore, for a sustainable improvement in PFM systems and effective use of fiscal space, the role of Federal Government will remain critical. Perhaps, Council of Common Interest and the proposed interprovincial forum may be a good place to highlight such issues.

1.41 Wage vs Non-Wage Budget Expenditures: Staff expenditure is protected. There are rigidities in both level of employment and remuneration structure. The government in general and the budget process in particular has a strong tilt towards public sector employment. The personnel-related budget, at least for the existing labor force, is generally not reviewed and released to every department early in the fiscal year; those for non-wage expenditure may face considerable delays and a much tighter scrutiny from the central departments (i.e. Finance and P&D). Moreover, the wage bill is protected as no re-appropriation is possible from wage to non-wage budgets; the opposite is not necessarily the case. This has created disincentives within departments for savings on wages to provide for insufficient allocation for O&M expenditure. Even the limit on the province's ways and means advance from the State Bank is set at the level of monthly salary of provincial staff, indicating that under an extreme situation when the province has no inflow of funds from any source, it is still able to pay the salaries of its staff. Over the last three years, the wage bill of the government has increased at an average rate of 30 percent per year, as the overall employment in the public sector has increased at 5 percent per year, whereas the salaries of provincial government staff increased by 24 percent per year (Table 1.7). Wage bill is growing at a rate which does not commensurate the rise in resources. Same is true for pension liability. This is clearly unsustainable and ultimately would result in lowering of essential development and O&M expenditures. Challenge will be more acute after 2013-14 with the drying up of Rs 25 billion per annum hydel profit arrears.

Table 1.7 Recent Trends in Provincial Employment and Wages

| | 2008/09 | 2009/10 | 2010/11 | Avg. annual growth |
|------------------------------|---------|---------|---------|--------------------|
| Provincial Government | | | | |
| Employment (Numbers) | 118,213 | 144,716 | 140,006 | 8.8% |
| Wages (Rs billion) | 13,883 | 20,445 | 26,471 | 38.1% |
| Implied Monthly Wage (Rs) | 9,787 | 11,773 | 15,756 | 26.9% |
| District Governments | | | | |
| Employment (Numbers) | 225,926 | 231,219 | 237,126 | 2.4% |
| Wages (Rs billion) | 26,699 | 30,793 | 42,143 | 25.6% |
| Implied Monthly Wage (Rs) | 9,848 | 11,098 | 14,810 | 22.6% |
| Overall Province | | | | |
| Employment (Numbers) | 344,139 | 375,935 | 377,132 | 4.7% |
| Wages (Rs billion) | 40,582 | 51,238 | 68,614 | 30.0% |
| Implied Monthly Wage (Rs) | 9,827 | 11,358 | 15,161 | 24.2% |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

1.42 Given the non-buoyant provincial own source revenues and almost total dependency on federal transfers, policymakers ought to choose carefully between short-term fixes and long-term sustainable solutions. Employment creation through private sector growth is far more desirable and sustainable than that through government resource allocation. Higher growth will result in faster job creation in the private sector, leading to declining unemployment and poverty levels. But this would require higher investments in both economic and social sectors.

1.43 Staffing is bottom-heavy: Although public employment in the province is not large compared to the population, it is comparatively large in relation to the available fiscal resources. In addition, employment structure is bottom-heavy, with about 70 percent of the provincial public-sector labor force employed in lower scales (i.e. BPS 1-

5).⁹ Although this reduces the average wage cost of employment, the skill levels and productivity of labor in the lower scales is also low, implying that even this low level of wage expenditure does not yield commensurate returns. The government wage bill and transfer payments (including pensions, interest payments, subsidies and grants) preempt, on average, about 70 percent of provincial recurrent expenditure. This may harm the province's ability to adequately adjust expenditure to revenue shocks or take additional development initiatives.

1.44 Lack of appropriate procurement regime: KP is the leading province in terms of procurement regulatory framework. Under the NWFP Procurement of Goods, Works, Services and Consulting Services Ordinance 2002 (later an act of parliament), rules for procurement of consulting services were notified in November 2002, and rules for procurement of goods, works and (non-consultancy) services were notified in December 2003. In order to rectify and improve upon the short comings in this statutory regime, provincial government in 2009 tabled a draft of the new procurement law in legislative assembly. The approval of this draft law is expected to bring in more transparency in public expenditures.

Box 1.3 Link Between Public Investment and Recurrent Expenditure—Changing Perceptions

Ensuring adequate resources for the downstream recurrent expenditures arising from public investment projects has been a problem in many developing countries. By the early 1980s, it was recognized that the recurrent expenditure implications of development projects had tended to be systematically underestimated and that this was leading to unsustainable demands on recurrent expenditure budgets. This led to considerable interest in the calculation of 'r' coefficients. These coefficients estimate the increase in recurrent expenditure implications of development expenditure (for any sector or sub-sector) by calculating the ratio of increased recurrent (O&M) and development expenditures. Once calculated, the 'r' coefficient could be used to determine an appropriate balance between recurrent and investment expenditures within a given resource framework.

In practice there were considerable conceptual difficulties with this approach, and the calculation of meaningful 'r' coefficients proved extremely difficult. Also, as recurrent budgets became increasingly under-funded, the analysis of the relationship between recurrent and investment allocations became less meaningful. At the same time, the incremental approach to budgeting implied by the use of 'r' coefficients was inappropriate for a situation where there were perceived to be considerable inefficiencies in public expenditure allocations and a consequent need for broad-based reform of public expenditure programs.

These problems have led to the emergence of a new paradigm in which public investment is seen as a consequence of decisions about the overall level of public spending in a sector rather than vice versa. For example, in primary education, determining public investment requirements can be seen as an iterative process that involves matching policy decisions about the desired type and level of education with the level of education services that can be afforded within the available financial resources and the investment requirements necessary to sustain that level of education services. Similarly in the roads sector, investment requirements arising out of decisions about the size of the road network that can be sustained within the available recurrent financing adversely affect project implementation, particularly during the project start-up phase. A contributory factor is disconnection between project management and responsibility for the wider policy and public expenditure framework within which the project has to operate. This in turn reflects limited sector policy and programming capacity at the sector ministry level, and capacity constraints in line division/department planning cells, in particular.

⁹ Our analysis for 2008-09 regarding education sector reveals that total number of teachers at primary level has risen by 0.8 percent while at secondary level by 2 percent from previous year. The number of non-teaching staff, however, has increased relatively significantly by 15 percent at the primary level and 12 percent at the secondary level.

1.45 Public Financial Management (PFM) emphasis is in control, not management: The system of allocation, disbursement and accountability to the government and legislature is control- rather than management-oriented. At all levels of PFM, the emphasis is on control over the volume and growth of expenditure rather than on achieving the desired outputs and outcomes. The system is excessively focused on ensuring regularity rather than efficiency of expenditures. The accountability apparatus is designed to censure infringements from set rules and regulations, but an inability to make planned improvements in delivery of public services is never questioned, let alone penalized. While financial audits are regularly undertaken, and there is well defined legislative oversight of the audit reports, performance audits are rare and qualitatively uneven. It is important to realize that this system needs to change if the reforms undertaken in recent past, which are more management and policy focused, are to deliver better development outcomes.

Box 1.4 Fiscal Implications for KP in View of the 18th Constitutional Amendment

After the 2001 devolution plan, the 18th Constitutional Amendment brought about a profound decentralization of government functions in Pakistan. While the 2001 plan devolved powers from provinces to local governments by eliminating the Concurrent List of the Constitutions which outlined the functions of federal and provincial governments, the 18th Amendment seeks to limit the role of federal government in as many as 27 functions relating to policy, regulation and delivery of social and economic services. It eliminated 17 federal government divisions and devolved some taxation powers, including GST on services and CVT on immovable property, to the provinces. It also sets out to clear the way for provinces to borrow directly from domestic and international sources.

The devolution contained in the 18th Amendment is likely to fundamentally change the way social and economic services are delivered. More importantly, by combining policy and implementation in a single tier of government, it would influence the quantity and quality of these services. Nevertheless, the estimated fiscal impact of this devolution is likely to be small, for three main reasons: (i) most of the devolved functions are small and represent services that provincial governments already provide; (ii) more than half of the federal budget for the devolved functions (prior to devolution) was for services which were, and will continue to be, delivered by the federal government in the Islamabad Capital Territory and other federal areas; and, (iii) some of the major functions (including HEC, the Population Program and vertical programs in the health sector) will continue to be financed by the federal government until 2015.

The fiscal implications for KP are likely to be even less impressive, as most devolved projects, and the largest, have been implemented in Punjab and Sindh. The overall development allocations (in the 2011 budget) for projects devolved amounted to only Rs 4.6 billion, where the recurrent cost of devolved functions was Rs 3.7 billion (see table below).

Box Table 1.4.1 Budgetary Allocations for Devolved Projects and Functions

| | Punjab | Sindh | KP | Balochistan | Total |
|--|----------------------|--------------|--------------|-------------|---------------|
| | <i>(Rs Billions)</i> | | | | |
| Development Allocations of Devolved Projects | | | | | |
| Location-Specific Projects | 3.2 | 2.5 | 1.2 | 1.9 | 8.8 |
| Vertical Programs | 13.8 | 6 | 3.4 | 1.3 | 24.5 |
| Total | 17 | 8.5 | 4.6 | 3.2 | 33.3 |
| <i>Province's Share in Total</i> | <i>51.1%</i> | <i>25.5%</i> | <i>13.8%</i> | <i>9.6%</i> | <i>100.0%</i> |
| Recurrent Budget of Devolved Functions | 7.6 | 9.1 | 3.7 | 0.9 | 21.3 |
| <i>Province's Share in Total</i> | <i>35.7%</i> | <i>42.7%</i> | <i>17.4%</i> | <i>4.2%</i> | <i>100.0%</i> |
| Total Fiscal Impact | 24.6 | 17.6 | 8.3 | 4.1 | 54.6 |
| <i>Province's Share in Total</i> | <i>45.1%</i> | <i>32.2%</i> | <i>15.2%</i> | <i>7.5%</i> | <i>100.0%</i> |

Source: WB staff calculations

1.46 Centralization overwhelms expenditure management: At the policy level, Pakistan, including KP province, transitioned from direct controls to arm's-length management through regulatory instruments and institutions. However, the civil service is not yet prepared for this role change, and has not adapted its management practices. This is most apparent in fiscal management where, instead of developing modern instruments of expenditure management—giving flexibility to line departments to adjust their priorities within the limited resources, with enforceable document-based checks and balances predicated on information flows—the central departments have centralized power, micromanaging expenditure, often in the guise of 'austerity measures'.

1.47 The recent devolution of functions from the federal to provincial governments under the 18th Constitutional Amendment will further test the weak administrative and financial capacity of the province. In the short-run, however, the fiscal impact of 18th Amendment is likely to be small (Box 1.4). Nevertheless, the province needs to begin preparing immediately if it hopes to use this devolution to improve delivery of its provincial services.

1.48 Procedural and institutional separation cements rigidity in budget formulation: Another important issue in expenditure management is procedural and institutional separation of the recurrent and development budgets. Though the time frame for preparation of the two budgets is the same, their channels of preparation and implementation are separated. The current budget is prepared, implemented and governed solely by the Finance Department (FD), while the formulation and execution of development budget is the purview of Planning and Development Department (P&DD)—although FD does have a say in setting the overall envelope available for development and in releasing the funds for development schemes (the latter on P&DD's recommendations). This separation creates many difficulties. Firstly, expenditure rigidities are enhanced as line departments receive budgetary funds under two separate and watertight heads, with no possibility of reallocation from one head to the other, irrespective of need. Secondly, the budget is prepared with two parallel yet different mechanisms, so the implications of development expenditure on the recurrent budget are not fully internalized, which generally leads to under-budgeting of O&M expenditures. Finally, with objectives and accountability of finance and P&DD restricted to budgets in their own domain, the effectiveness of the expenditure management system is compromised.

1.49 In addition, the artificial compartmentalization of budget making promotes the apparent practice of delaying the transfer of completed development budget projects to the recurrent budget—when there are insufficient recurrent budget resources to cater for these. This implies a clear breakdown in the fundamental budgeting principle of linking expenditure plans to anticipated resource availability within a clear and appropriate framework.

1.50 Capacity and knowledge gaps, the missing link in the reform process: Despite substantial reforms effort, service delivery has not improved much as indicated by health and education outcomes. A brief snapshot of comparison between PEFA undertaken in 2007 and 2011 indicates the weakness in PFM system as reforms, though impressive, have not substantially improved the outcomes of PEFA assessment over time. The expected outcome of all these reform initiatives is an improvement in service delivery to citizens through efficient allocation and utilization of resources and process reengineering. All these require dynamic and evolving government machinery that responds to changing ground realities. Despite some pockets of excellence within the government structure, disconnect between reforms and their impact on the PEFA scores can 'partly' be explained by lack of capacity development within government—especially in line departments, in general. Bridging the capacity and knowledge gaps (especially in PFM domain) is a cross-cutting theme and tackling this issue would provide an enabling environment for nurturing reform process. For detailed discussion on this issue please see Annex 4.

1.51 Expenditure is biased in favor of development if measured through usage of available fiscal space: In KP, as throughout Pakistan, there is an inherent bias towards the development budget. The government and general public tend to regard development expenditure as the only government expenditure that induces growth, while most of the recurrent budget, if not all, is seen as a waste of money. This mindset is responsible for three related outcomes:

- (i) Most of the increases in fiscal space are devoted to financing development budgets, with little being channeled towards repairs and maintenance (R&M). This reflects a bias towards asset creation rather than

adequate maintenance and operation of assets. It is no surprise, therefore, that provincial service quality tends to be low, despite adequate infrastructure.

- (ii) It is considered good expenditure management practice to compress recurrent expenditure. As noted above, recurrent expenditure is beset by structural rigidities; hence the only flexible component, the operations and maintenance (O&M) budget, suffers the brunt of this compression.
- (iii) An 'over-extension' of infrastructure without commensurate increase in the O&M budget leads to not only poor quality of provincial services but an early erosion of infrastructure, forcing the government eventually to fund its deferred O&M from the development budget as rehabilitation projects.

1.52 Resource availability has raised expenditure on development and recurrent programs but not on maintenance: Accelerating growth requires not only increasing the overall level of public expenditures but also improving the composition and efficiency of those expenditures. This implies more emphasis on O&M and better management of investment projects. It is imperative that KP increases its O&M spending to preserve the value and productivity of public capital stock, with benefit for past and future investments. Increased fiscal space, over the last three years, has enabled the province to increase its development budget share to around 22 percent in 2010-11 (Table 1.8). In 2010-11, about 1.5 percent of total expenditures were incurred on repair and maintenance, which are insufficient given the quantity of capital stock. Repairs and maintenance declined relative to total development expenditures from 10 percent in 2008-09 to just 6.8 percent in 2010-11. Allocating appropriate sums for repairs and maintenance would tantamount to a 'build-and-maintain' strategy rather than one of 'build- neglect-and-rebuild'.¹⁰ Recurrent expenditure—in last three fiscal years—has also increased on average at about 30 percent during last three fiscal years—though mainly because of large increases in employees' salaries, which the government is pressed to approve because of persistently high inflation. The share of expenditure devoted to repairs and maintenance actually declined.

Table 1.8 Recent Changes in Composition of Provincial Expenditure

| | 2008/09 | 2009/10 | 2010/11 |
|----------------------------------|-------------|-------------|-------------|
| Total Current Expenditure | 80% | 80% | 78% |
| Employees Related | 25% | 25% | 27% |
| Pension | 4% | 3% | 4% |
| Operating Expenses | 6% | 8% | 7% |
| Pension | 4% | 3% | 4% |
| Grants & Transfers | 24% | 23% | 25% |
| Interest | 4% | 3% | 3% |
| Repairs & Maintenance | 2% | 2% | 1% |
| Others | 10% | 13% | 6% |
| Development Expenditure | 20% | 20% | 22% |
| Total Expenditure | 100% | 100% | 100% |
| <i>Memo item:</i> | | | |
| Ration of Repairs to Development | 10% | 8% | 7% |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations¹¹

¹⁰ The underfunding of O&M expenditure is not unique to Pakistan or KP. Many developing countries face the same tough choice of allocating their scarce fiscal resources to development and O&M budgets. Though most are aware of the fallout from the practice, many developing countries continue to underfund their O&M budgets. Attempts have been made in the economic literature to develop a yardstick by which to measure the adequacy of an O&M budget in relation to development expenditure (Box 1.3). However, no perfect yardstick yet exists to help budget makers determine the optimal allocation of their fiscal resources.

¹¹ The district salaries in this Table are shown in under Grants and Transfers. This transfer is overwhelmingly used for employee's related expenses. Therefore in reality employees related expenses are much larger than what is reflected in the Table.

1.7 Evolving Expenditure Status—Investment Trends

1.53 The weak state of social services coupled with a perilous security situation presents enormous challenges to the government. Social unrest in parts of KP and its adjacent areas is perhaps due to widespread poverty and lack of opportunity among people. A key message of PCNA was that lack of opportunity and poor service delivery are main drivers of social discontent, and a catalyst to militancy. Provincial government realizes that it is imperative that concerted efforts be made to provide people with better opportunities for livelihood and to improve service delivery, especially in social sectors.

1.54 The KP government recognizes that if the province is to achieve its broader goals of poverty reduction and provision of better employment opportunities and living standards to its people; it must sustain a substantially higher rate of economic growth than in the past, and step up investment in human capital and growth-generating economic sectors, such as electricity generation, oil and gas exploration and minerals.¹² Economic growth would result in job creation in the private sector, leading to declining unemployment and poverty levels. The following section analyzes the development policy framework of the province and highlights initiatives by which to effectively implement this framework.

1.55 The KP government's development priorities are reflected in the Comprehensive Development Strategy (CDS), Economic Growth strategy (EGS) and Post-Crisis Needs Assessment (PCNA). The focus of these initiatives is to reduce poverty and create opportunities for KP population by increasing investments in employment- and growth-generating sectors such as mining, oil and gas exploration, hydel generation etc. It is also realized that social sectors are important for development of the province—there is a need generate new investment and to consolidate existing investments in these sectors. The CDS is a medium-term framework anchored by sector strategies. In EGS it is assumed that public investment in economic sectors such as hydel generation, oil and gas exploration and minerals sector will have positive spillovers for the provincial economy and will help stimulate private sector growth and thus create jobs. However, there is no clear cut link in literature which firmly establishes relationship between public investment and growth. For instance, a World Bank report has stated that there is no clear evidence to expect that public investment would spur growth. Devarajan, Swroop and Zou (1996)¹³ found a negative relationship between public investment and growth. Ghani and Musleh-ud-din (2006)¹⁴ failed to find any positive impact on growth through public investment in Pakistan. Therefore, public investment in economic sectors as envisioned in the CDS and EGS alone may not be sufficient to accelerate growth and reduce unemployment. Investment in 'soft' aspects such as education, health and law and order cannot be ignored.

1.56 In recent years, the KP provincial government has commendably tried to be more consultative in the budgeting process, especially with regard to development expenditures. Public expenditures ought to reflect and respond to political concerns. Although there have been complaints about political involvement in the budgeting process, it is important to distinguish between desirable political interventions and those that would seek to undermine effective and efficient allocations. Politicians should make decisions that set the broad policy parameters and priorities at macro level. However, political interferences at micro level—affecting decisions about specific projects, site locations, appointments and transfers of government staff and the like—usually undermine the budgetary process and detract from its ultimate objectives.

¹² Post Crisis Needs Assessment (PCNA), Comprehensive Development Strategy (CDS) and Economic Growth Strategy (EGS) of the KP government.

¹³ Devarajan, S, Swaroop, V, & Zou, H (1996), 'The composition of public expenditures and economic growth', *Journal of Monetary Economics*, no. 37, pp. 313–44.

¹⁴ Ghani, E & Musleh-ud-din (2006), 'The impact of public investment on economic growth in Pakistan', *The Pakistan Development Review*, vol. 45, no. 1.

1.57 Inter-provincial comparison shows that overall development expenditures increased significantly in the second-half of the last decade, but less so in KP relative to larger provinces. On average, development expenditures grew relative to national GDP in all provinces over the last decade. However, this growth was more pronounced in Punjab and Sindh provinces. KP's development expenditures, on average, grew less than its two larger counterparts—by a mere 0.1 percent of GDP to 0.3 percent from 2006-10, and from 0.2 percent from 2001-05 (Figure 1.6, left panel). In absolute terms, development expenditures rose in the last few years but their share of overall expenditures declined in last three years (Figure 1.6, right panel). Figure 1.6 also shows current and development expenditures increasing at a healthy pace from 2007-08, especially the last two years. Nevertheless, the development share of total expenditures, which was 33 percent in 2007-08, declined to 28 percent in 2010-11. To contribute to economic growth in the province and support private investment, both the level and the composition of provincial public investments has to improve. As a percentage of provincial GDP, current expenditures increased from 5.3 percent in 2008-09 to 7.6 percent in 2010-11, while development expenditure only rose to 3.0 percent of GDP from 2.3 percent in the same period. Most of the fiscal space created due to the Seventh NFC award went towards raising current expenditures by substantially increasing payment of pensions, remuneration and recruitment of new employees.

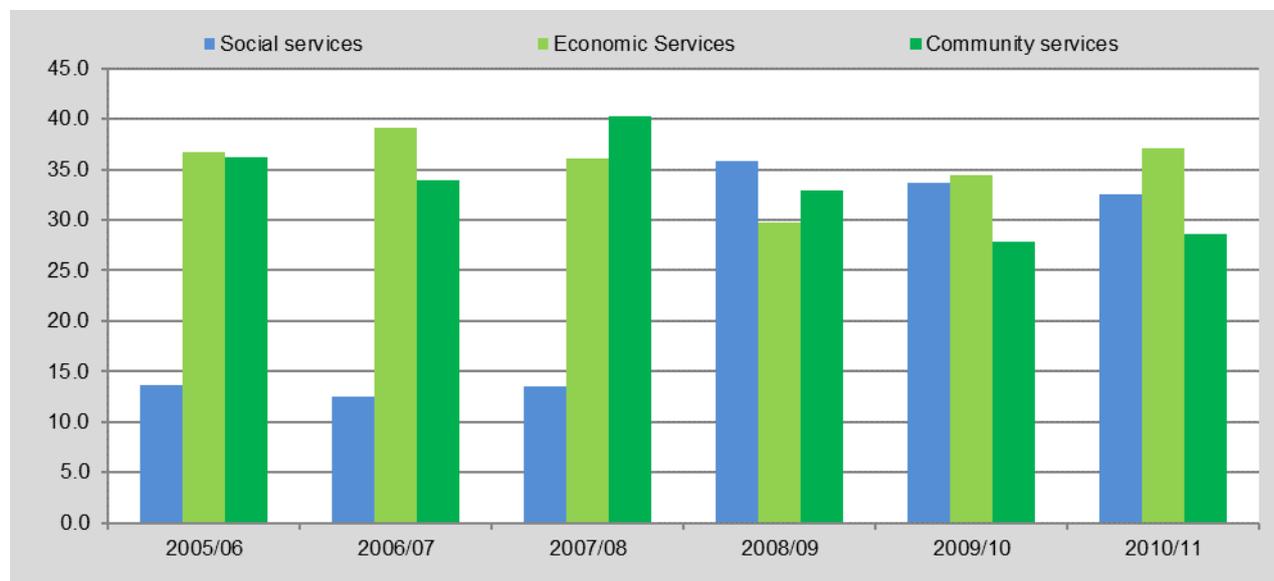
Figure 1.6 Expenditure Trend and Development Expenditure (as % of NGDP)



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

1.58 Capital assets productivity was eroded by low maintenance spending. As mentioned in the previous section, low spending in O&M is eroding the value and productivity of existing public capital stock and could soon be described as 'sunken cost', with the decline in O&M's share of total expenditure. As of 2010-11, this declined to 6.8 percent of total expenditure from 10 percent in 2008-09.

Figure 1.7 Sectoral Share in Development Expenditures



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Sectoral Priorities

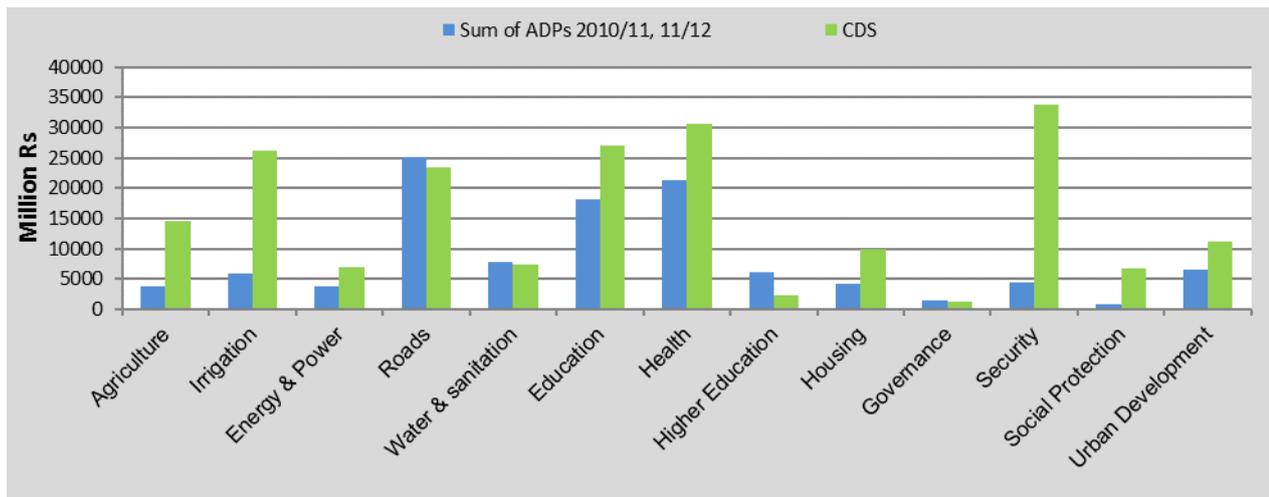
1.59 The social sector is one key focus of development expenditure outlays. There was a paradigm shift in sectoral expenditure in 2008-09, towards the social sector at the expense of economic and community services sectors. Investment in social spending¹⁵ increased significantly, to an average of 34 percent of development expenditure during 2008-09 to 2010-11, compared to 13 percent during 2005-06 to 2007-08. Much of this expansion was in education and health expenditure. The education sector share increased to 23 percent in 2008-09, and hovered around 20 percent in 2010-11, compared to 7 percent in 2007-08. The education sector saw secondary education's share rise to 10.5 percent of overall spending in 2008-09, from 3.4 percent in 2007-08. The CDS and EGS emphasize consolidation of social sectors, away from bricks and mortar; so the social sector's share of development spending is marginally declining since then in line with this policy, though it still remains above 30 percent.

1.60 Investment in the economic sector¹⁶ has remained relatively static. Economic sector spending has averaged around 37 percent of total development expenditure from 2005-06 to 2007-08. However this declined to 30 percent in 2008-09 but bounced back to around 37 percent in 2010-11 in line with government growth strategy outlined in the CDS and EGS with renewed focus on these sectors. Yet, for some key growth- and employment-generating sectors, allocations fell short of what was envisioned in CDS (Figure 1.8). One reason for this gap is a diversion of Rs 16.8 billion for new portfolios in 2011 for flood damage rehabilitation.

¹⁵ Education, health, population services and social protection.

¹⁶ Agriculture, irrigation, fuel & power, industries and mineral resources, and transport and communications.

Figure 1.8 Actual Allocations vs. CDS



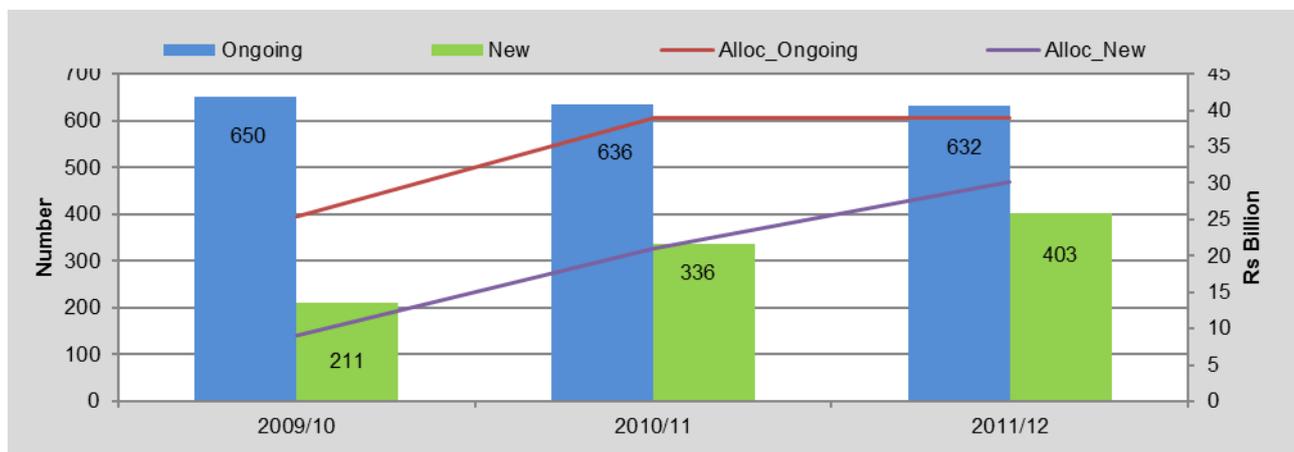
Source: FD and P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations.

1.61 Expenditure on community services¹⁷ has declined substantially. This sector's share of spending fell from an average 37 percent during 2005-08 to 30 percent during 2008-11. While subsector expenditure in highway increased to 22 percent from 13 percent, expenditure in building structures was insignificant in 2010-11 compared to Rs 6.8 billion (or 22 percent of overall development expenditures) in 2007-08.

Number and Size of Projects

1.62 The development portfolio increased in sheer number of new schemes and allocations in last few years (Figures 1.9). It is unlikely that capacity to adequately prepare, manage and monitor the development program has substantially improved, at either the P&DD or line department level. A large portion of development portfolio consists of relatively new projects. For 2009-10, 2010-11 and 2011-12, new projects are 25 percent, 35 percent and 39 percent of the total portfolio, respectively. For 2011-12 portfolio, given the allocations, about 76 percent of total portfolio would be less than half complete.

Figure 1.9 Number of Schemes



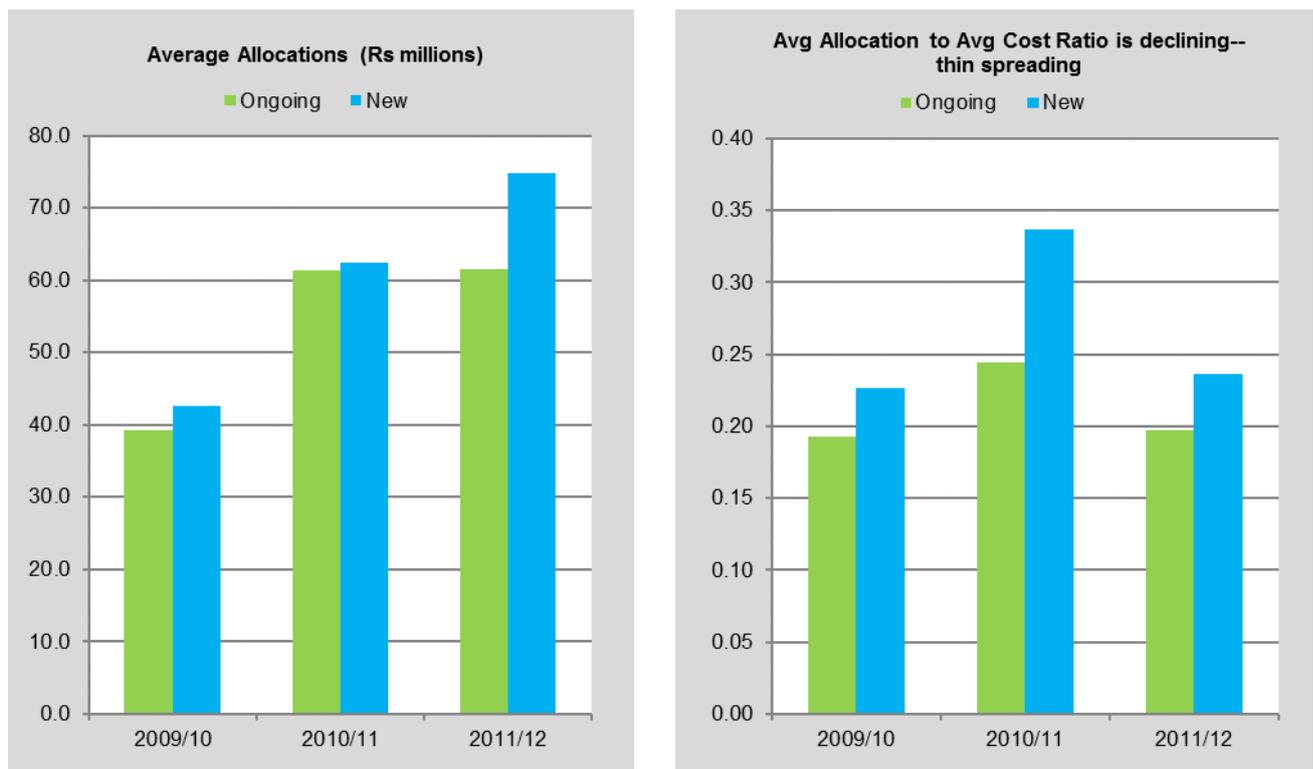
Source: FD and P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations

¹⁷ Works, highways, roads and bridges, and buildings and structures.

1.63 A significant portion of development portfolio consists of relatively small projects, which implies higher-than-desired overhead costs of implementing the development program. About 57 percent of projects in 2011-12 portfolio cost Rs 100 million or less, with a total allocation of only Rs 9.0 billion (13 percent of total allocation). These relatively low allocations in the current fiscal year indicate that the projects will pose larger resource demands in the future.

1.64 The average allocation per scheme is increasing (Figure 1.10, left panel), but this is more pronounced in new projects than ongoing projects. The ratio of average allocation to average cost declined in the 2011-12 portfolio (Figure 1.10, right panel)—a thin spreading of resources which is bound to delay timely completion of projects and result in huge cost overruns and diminishing of economic benefits. One consequence of relatively small projects is that the management is relatively centralized and defies economies of scale.

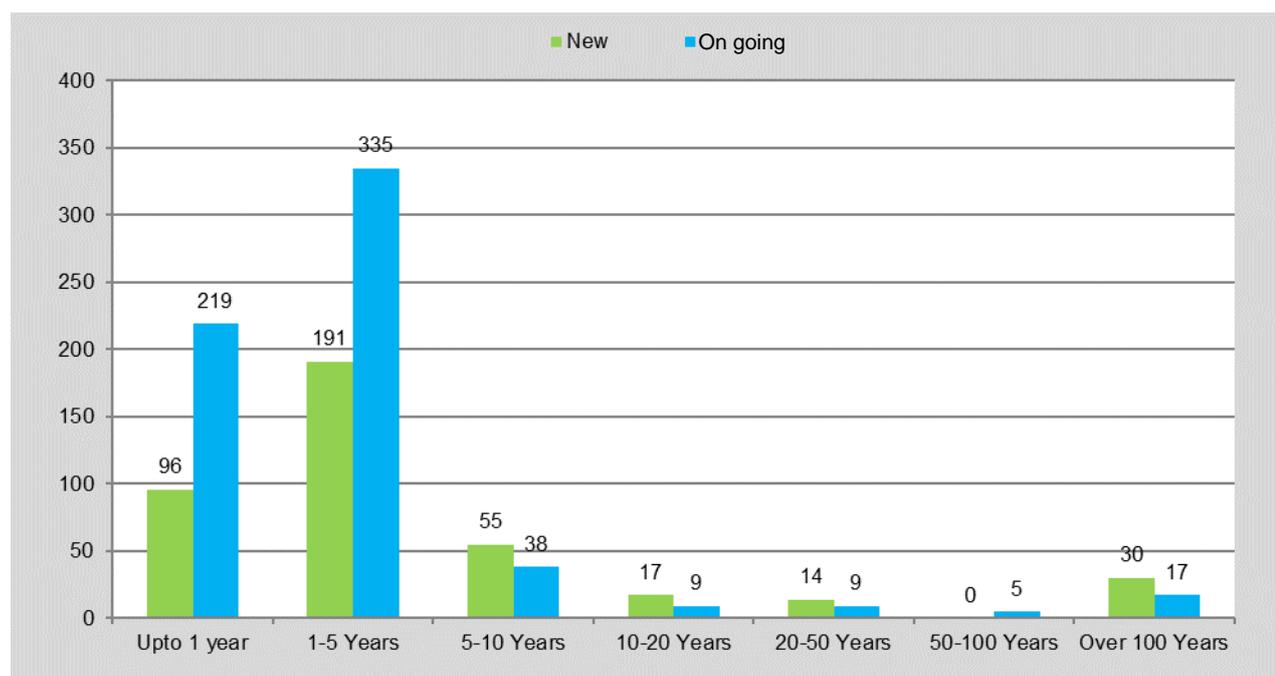
Figure 1.10 Average Allocation to Average Cost Ratio is Declining...thin Spreading



Source: P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations

Throw-Forward of Development Portfolios

1.65 The inclusion of a significant number of new projects in the portfolio every year contributes to substantial throw-forward of commitments. Allocation for some of the projects is clearly insufficient to ensure timely completion. The ADP of 2011-12 has 63 projects with allocations of Rs 1 million or less. There are 194 projects (78 are ongoing) which at present rate of allocation will take over 10 years to complete. There are 17 ongoing projects that would require over 100 years completing (Figure 1.11).

Figure 1.11 Years of Throw-Forward, 2011-12

Source: P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations

1.66 There is a need to clean this portfolio by undertaking the following actions, among others:

- Reevaluate the economic and financial viability of schemes that have been significantly delayed.
- Defer or be selective in adding new schemes to future portfolios.
- Eliminate (as many as possible) projects from future portfolio that are allocated less than 10 percent of their throw-forward.
- Terminate all projects that are not aligned with the CDS, EGS and sector strategies.
- Review all deferred/dropped projects, at par with new projects, for their economic and financial viability, prior to any re-inclusion in future development programs.
- Undertake, on a mandatory basis, a fiscal impact analysis of every project before its inclusion into the development program.

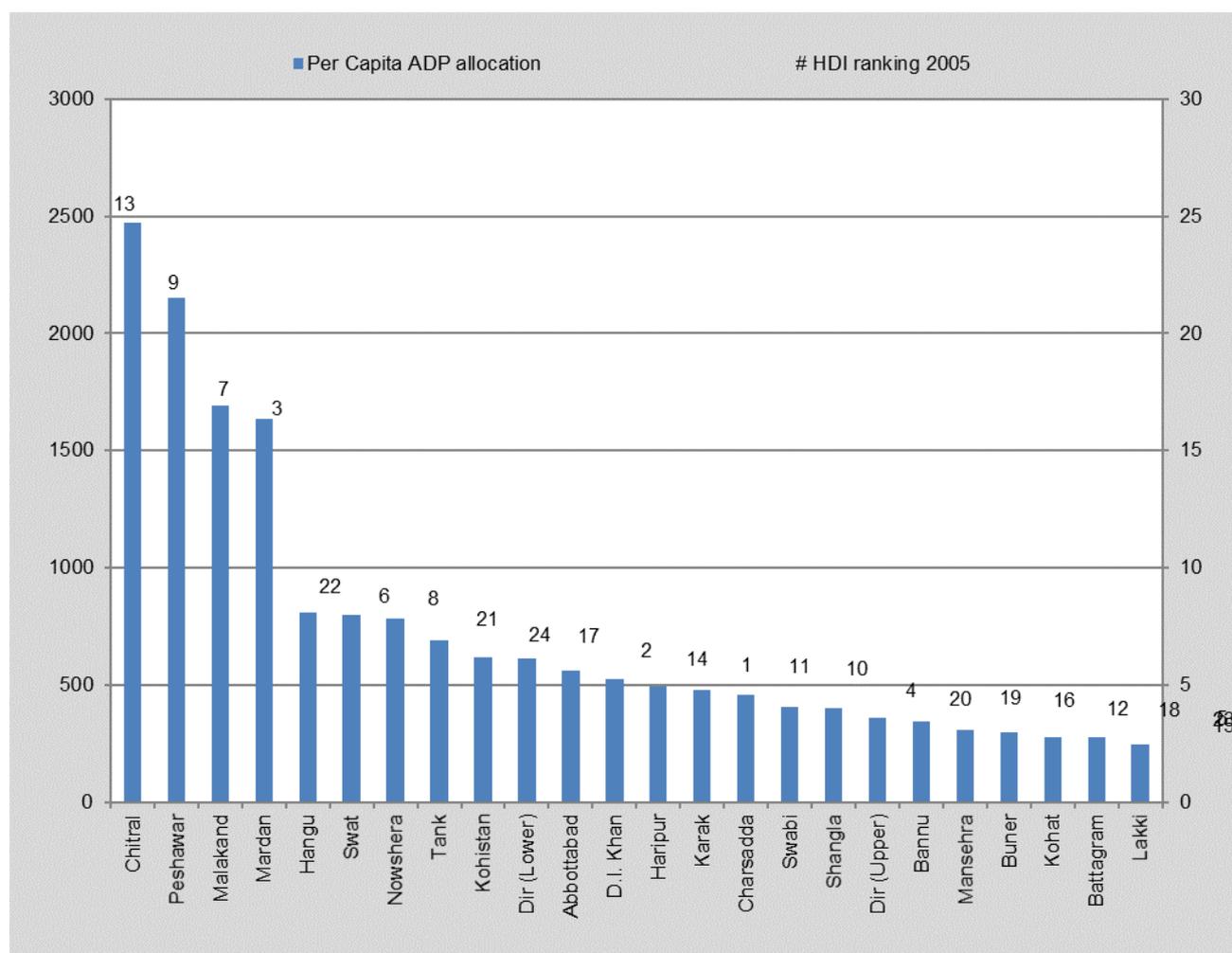
1.67 Relatively developed districts crowd out less developed districts in annual development plan allocations. Per-capita allocation of development expenditures in 2011-12 ADP indicates that least-developed areas¹⁸ of the province receive the least funds (Table 1.9). Of the 403 new schemes, 183 are for specific districts. Of these, 63 percent are for Peshawar, Mardan, Swat, Chitral and Mansehra, which covers around 36 percent of the provincial population. Similarly, 48 percent of ongoing schemes for districts, with 58 percent allocation, are undertaken in these five districts. Individual allocations to district development schemes in relation to their Human Development Index ranking clearly shows that least-developed districts are receiving the smallest allocations for development spending (Figure 1.12).

¹⁸ Trends in Regional Human Development Indices”, Research Report No 73, 2005, SPDC, Karachi

Table 1.9 District Allocations, ADP FY2012

| | Schemes | | Allocation | |
|---------------------|---------|----------|------------|----------|
| | New | On going | New | On going |
| Provincial | 220 | 287 | 23120 | 24398 |
| Districts | 183 | 345 | 7129 | 14352 |
| Peshawar | 64 | 86 | 1809 | 4336 |
| Mardan | 18 | 36 | 1051 | 2226 |
| Swat | 10 | 19 | 381 | 955 |
| Chitral | 10 | 14 | 448 | 583 |
| Mansehra | 11 | 11 | 235 | 236 |
| Remaining Districts | 113 | 166 | 3923 | 8336 |

Source: P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations

Figure 1.12 Per Capita Allocations Compared to HDI Rankings

Source: P&DD, Government of Khyber Pakhtunkhwa and WB staff calculations

1.8 Reform Options for Improving Fiscal Management

1.68 Khyber Pakhtunkhwa made an exceptional start in reforming its finances. Those reforms need to be continued, revitalized and built upon to create additional fiscal space and improve and ensure the effectiveness of the province's budgetary expenditure. Some actions that the government should consider, for achieving these objectives, are discussed as follows.

Revenue Mobilization

1.69 With the significant increase in federal transfers, Khyber Pakhtunkhwa's revenue position has improved noticeably. However, there is hardly room for complacency. In order to finance the development of the province, additional fiscal space is required. In addition, the provincial (and local) taxes need to be aligned and reformed to reduce their disruptive impact on economic activity. The province, therefore may consider:

- Further reducing the number of taxes and tax categories (for example stamp duties) so as to reduce the non-pecuniary costs to taxpayers. This would ensure better compliance and promote the provincial economy.
- Reviewing provincial taxes and tax exemptions to enhance tax bases. This is specifically relevant for AIT and UIPT where ad hoc and politically-driven exemptions have not only narrowed the tax bases but have also created fiscal inequities in the province.
- Ideally, profession and calling tax should be amalgamated with income tax, with the province getting the revenue on a collection basis. If that is not possible, there is an urgent need to resolve the problem of overlapping jurisdictions between provincial tax and local government levies. At present, as per the provision of NLGO, the local governments (especially cantonment boards) have levied the profession and calling fee more or less in the same manner as provincial tax. This runs the risk of payers' litigation on the grounds of double taxation. It may be advisable that both the tax and the fee be amalgamated into a single tax, which is collected by the provincial government, the revenue then could be shared between the provincial government and cantonment boards/town governments on some pre-agreed formula.
- Similarly, there is need to resolve the issue of overlap of federal CVT and withholding tax on motor vehicles and the provincial MVT.
- Improving tax administration by building its technical and managerial capacity; enhancing the autonomy of tax administration departments; providing better incentives for improved performance; computerization of tax records; and linking tax bases across taxes and the governments through better sharing of information between provincial Board of Revenue, E&TD and the provincial tax agencies and FBR.

Expenditure Management

1.70 As with provincial revenue, Khyber Pakhtunkhwa needs to revitalize and further its expenditure management reforms. This may require:

- Developing a well-designed debt-management strategy. Given the borrowing powers conferred to provinces in 18th Constitutional Amendment, KP may consider revisiting its debt recording and management system in collaboration with the Economic Affairs Division at federal level (as Punjab is doing). This would help further manage the debt at provincial level and allow policy makers to make informed decisions.
- Given the huge expected pension liability, province may consider improving the pension fund management which would also help in reducing the claim on the budget of pension payments.
- Strengthening the process, already in place, of implementing output-based budget allocation for all new schemes. This would move away from the current practice of artificially splitting the current and development

budget allocation. It would start by initiating a process of consultative agreement between the FD, P&DD and the line agency to achieve measurable output indicators.

- Improving the effectiveness of public expenditure by providing a better balance between the development and O&M budgets.
- Payroll and pension budget is increasing at a rapid rate. This has significantly impacted the budget credibility due to substantial variations between estimated payroll budget and actual payroll expenditure. There is a need to comprehensively tackle the issue of payroll. Finance Department may commission a study on the sustainability of salary budget and analyze the relevance of salary budget with service delivery.
- Release procedures need to be revised to ensure smooth implementation of the budget. It may be appropriate to adapt and adopt the Federal Government's 'New System of Financial Control and Budgeting' to streamline releases for recurrent and development budgets.
- Project design of new activities needs to be strengthened by empowering P&DD in such a way that no new large activity can be budgeted for implementation without an approved feasibility study.
- Demand side of good governance needs to be strengthened by expanding the current partnership with local stakeholders to monitor the progress made on budget output indicators of important projects and programmes.

Chapter 2:

The Education Sector

2.1 Introduction

2.1 Education faces severe challenges because of insufficient allocation of resources. An even bigger challenge is being able to use existing resources efficiently and effectively. This report examines the overall performance of the education sector and seeks to analyze the adequacy and effectiveness of investments made in Khyber Pakhtunkhwa (KP) to improve education outcomes. It concludes with recommendations based on key trends identified.

2.2 The review focuses only on primary and secondary education, as these two sub-sectors consume the vast majority of educational resources, manpower and attention. Management of technical, vocational and tertiary education differs substantially from that of primary and secondary education—tertiary education, especially universities, is funded mostly by Federal Government, while adult and non-formal education receive little funding at all.

Box 2.1 Main Education Sector Messages

- A rough estimate suggests that at current rate, KP may achieve 100 percent primary enrollment in 35 years. While more funds are needed for education as a whole, KP is currently spending much more on secondary education than on primary education.
- Despite increased funding, more and fully-qualified teachers, wide availability of schools, improved facilities and access to schooling has stagnated while learning levels also remain low.
- More nuanced, localized policies are needed to better target local issues.
- The inadequate non-salary allocations need to be increased. Operational spending on both primary and secondary education, already meager, has fallen further in the last three years

2.2 Recent Educational Reforms

2.3 The 18th Amendment to the Constitution of Pakistan (April 2010) devolved the education sector management policy, planning and curricula, to the provinces. It also recognized the right to free primary and secondary education as a fundamental constitutional right, thereby making it justifiable. Provinces, now fully responsible for funding and day-to-day management of the sector other than universities, are gearing up to fully discharge the responsibility.

2.4 The National Finance Commission (NFC) Award is the mechanism that determines revenue collection and sharing among provinces, and between provinces and the federal government in Pakistan. In advance of passage of the 18th Amendment, the Seventh NFC Award (November 2009) increased the provincial share to 56 percent from the 48.75 percent agreed under the Fifth NFC Award in 1997. KP and Balochistan benefited proportionally more from

the new sharing arrangement because it took account of poverty levels and state of underdevelopment for the first time.

2.5 An Education Sector Plan (ESP) 2008-15 was prepared in 2008. In line with the national vision, the ESP aims to “provide quality education to all citizens so that they can realize their maximum potential, produce responsible and skilled citizens, and integrate Pakistan into the global framework of economic development that focuses on human capital”. Prepared for the first time in any province, the ESP contains measures for “reducing regional and gender disparities, access to opportunities, quality, infrastructure, and training of teachers, risk management and governance”.

2.6 The local governance framework has been unclear. In 2008, all provincial governments took administrative control of the local government system. In May 2012, the KP Assembly unanimously passed a bill for local governance, replacing the Local Government Ordinance of 2001. The legislative changes would formalize the de facto provincial role in education that has existed since 2008, and revert to the situation in effect prior to 2001. The organization of education districts and vertical accountabilities are also likely to change as the law takes effect. It would, for example, dissolve the Provincial Finance Commission that has allocated resources between the province and districts and hand all planning and development functions to the province.

2.3 Overview of the Education Sector in Khyber Pakhtunkhwa—Key Trends

2.7 The sector has seen only modest success in recent years (Table 2.1). Enrollment has increased by about 6 percent at primary level and almost 9 percent at secondary level since 2006-07. While the total number of schools has risen at both levels, the number of students per school at the primary level has also increased over the last three years, implying greater enrollment even in existing schools. At secondary level, the number of students per school has remained largely stable, at about 215 students per school, and the overall number of students per classroom has remained roughly the same, indicating that provision of new classrooms is just keeping pace with the increased enrollment.

2.8 The proportion of female participation in schools, especially at the primary level, has improved over the last five years. At primary level, the proportion of schools for females remained the same in this period, but the number of secondary schools rose by 3 percentage points. Enrollment of female students rose 1 percentage point at the primary level and 4 percentage points at the secondary level. The relative share of female teachers in public education also increased by 2 percentage points to 36 percent at the primary level and by 4 percentage points to 30 percent at the secondary level. The gains were more modest during the last three years.

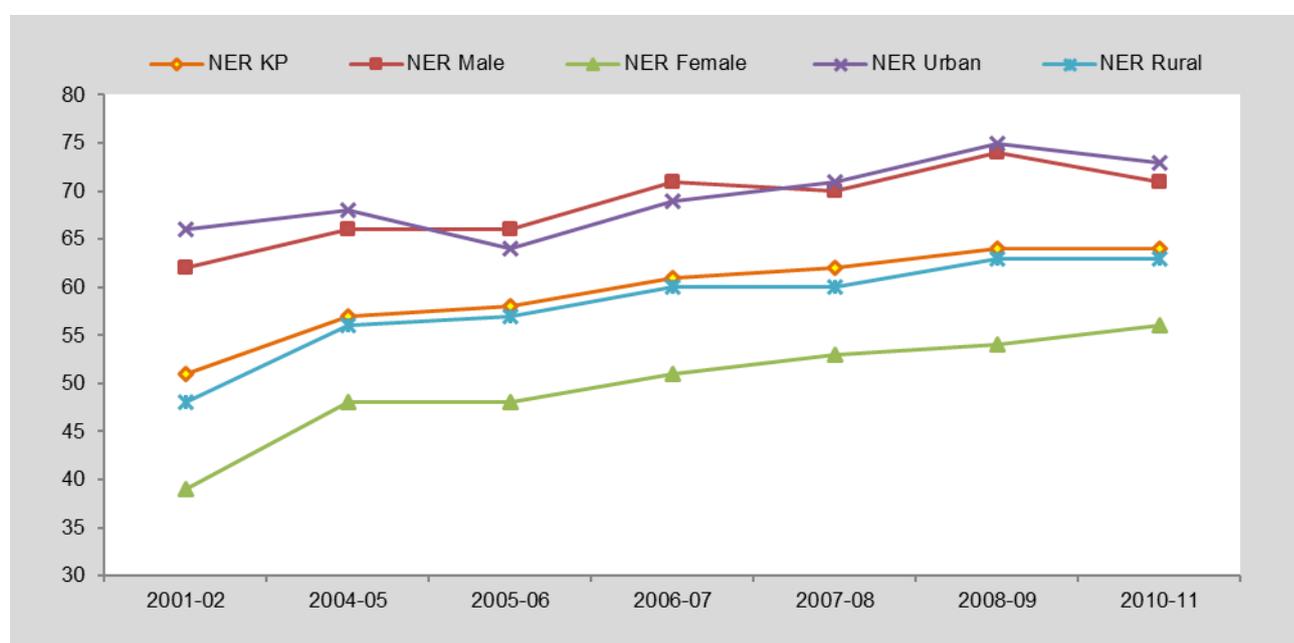
2.9 Net enrollment rates have modestly improved in the last 10 years. The rate for the 6 to 10 year-old group has risen consistently since 2002, from almost 51 percent to 64 percent (Figure 2.1), implying average growth of 1 percent per annum—though enrollment stagnated in the last three years. In absence of any scientific study, a rough estimate suggests that at this pace, Khyber Pakhtunkhwa would achieve the MDG of 100 percent primary enrollment by 2045.

2.10 Net enrollment rates (NER) in the age cohort of 6-10 are highest for male students and those in urban areas, at approximately 71 percent and 73 percent since 2002. However, NER growth for male students in the last 10 years has remained low, going from 62 percent to 71 percent. Meanwhile, the female cohort, though numerically smaller than its male counterpart, has grown its NER consistently faster than the male, from 39 percent to 56 percent. The NER in rural areas has also risen sharply, from 48 percent to 63 percent since 2001-02.

Table 2.1 Key Data for Education in Khyber Pakhtunkhwa

| | Primary | | | | | Secondary | | | | |
|---|-----------|-----------|-----------|-----------|-----------|-----------|---------|---------|---------|---------|
| | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 |
| Number of Schools | 22,281 | 22,466 | 22,926 | 23,005 | 23,114 | 4,217 | 4,400 | 4,478 | 4,530 | 4,619 |
| No. Female | 7,627 | 7,745 | 7,631 | 7,681 | 7,838 | 1,396 | 1,510 | 1,540 | 1,580 | 1,642 |
| % Female | 34 | 34 | 33 | 33 | 34 | 33 | 34 | 34 | 35 | 36 |
| Number of Students | 2,625,527 | 2,758,656 | 2,653,724 | 2,654,285 | 2,776,642 | 909,001 | 943,620 | 935,249 | 942,795 | 987,154 |
| No. Female | 882,522 | 940,346 | 913,633 | 913,932 | 960,847 | 276,776 | 295,115 | 300,394 | 306,572 | 332,349 |
| % Female | 34 | 34 | 34 | 34 | 35 | 30 | 31 | 32 | 33 | 34 |
| Number of Teachers | 67,299 | 71,039 | 70,438 | 70,621 | 70,995 | 41,801 | 44,334 | 43,789 | 43,541 | 44,715 |
| No. Female | 23,218 | 25,095 | 24,991 | 25,037 | 25,591 | 11,016 | 12,391 | 12,449 | 12,768 | 13,514 |
| % Female | 34 | 35 | 35 | 35 | 36 | 26 | 28 | 28 | 29 | 30 |
| No. of Non-Teaching staff | NA | 19,224 | 17,836 | 18,665 | 20,495 | NA | 18,243 | 17,834 | 18,513 | 20,005 |
| Number of Classrooms | NA | 60,507 | 60,213 | 61,676 | 63,394 | NA | 25,299 | 25,671 | 26,310 | 27,183 |
| Student Teacher Ratio | 39 | 39 | 38 | 38 | 39 | 22 | 21 | 21 | 22 | 22 |
| No. Female students as % of Male Students | 52 | 53 | 50 | 50 | 51 | 49 | 52 | 52 | 54 | 55 |
| Recurrent Expenditure per Student | 3,042 | 3,520 | 4,432 | 5,254 | 6,085 | 8,557 | 10,024 | 11,821 | 13,748 | 17,436 |
| No. Students per classroom | NA | 46 | 44 | 43 | 44 | NA | 37 | 36 | 36 | 36 |
| No. Students per School | 118 | 123 | 116 | 115 | 120 | 216 | 214 | 209 | 208 | 214 |

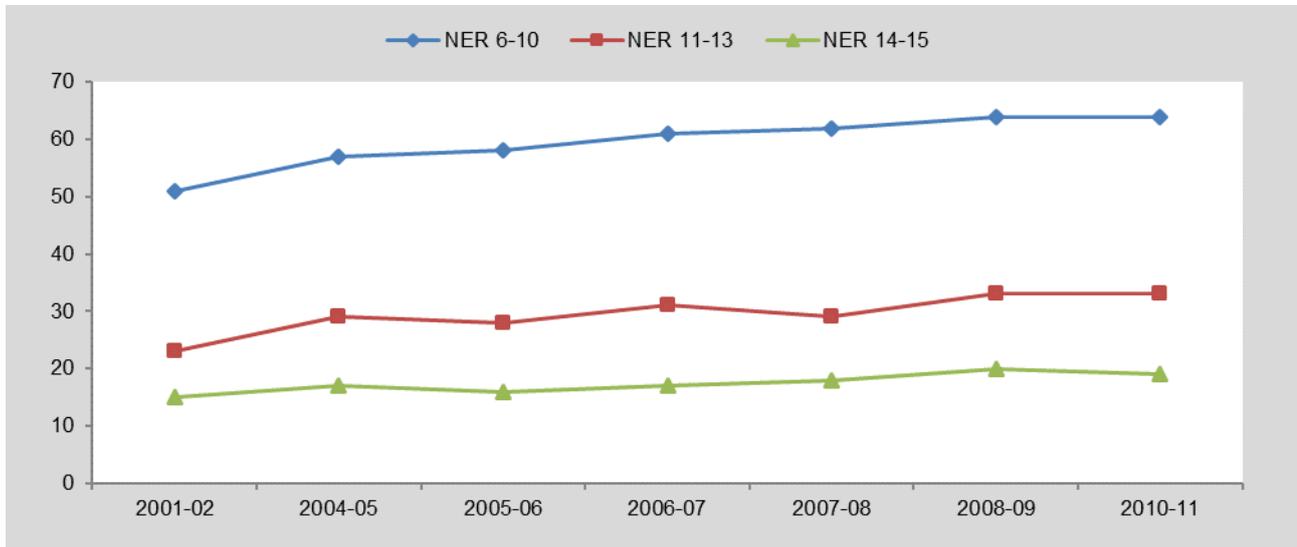
Sources: Khyber Pakhtunkhwa EMIS 2007-11 and expenditure data from PIFRA

Figure 2.1 Net Enrollment Rates (Ages 6-10)

Source: PSLMS

2.11 Stagnation is also apparent in the NERs of other age levels (Figure 2.2). The age cohort 14-15, for example, has barely changed, increasing its NER from 15 percent to 19 percent in the last 10 years, and the 11-13 year cohort rate rose by an average of 1 percent per annum. The growth slope flattened in each case.

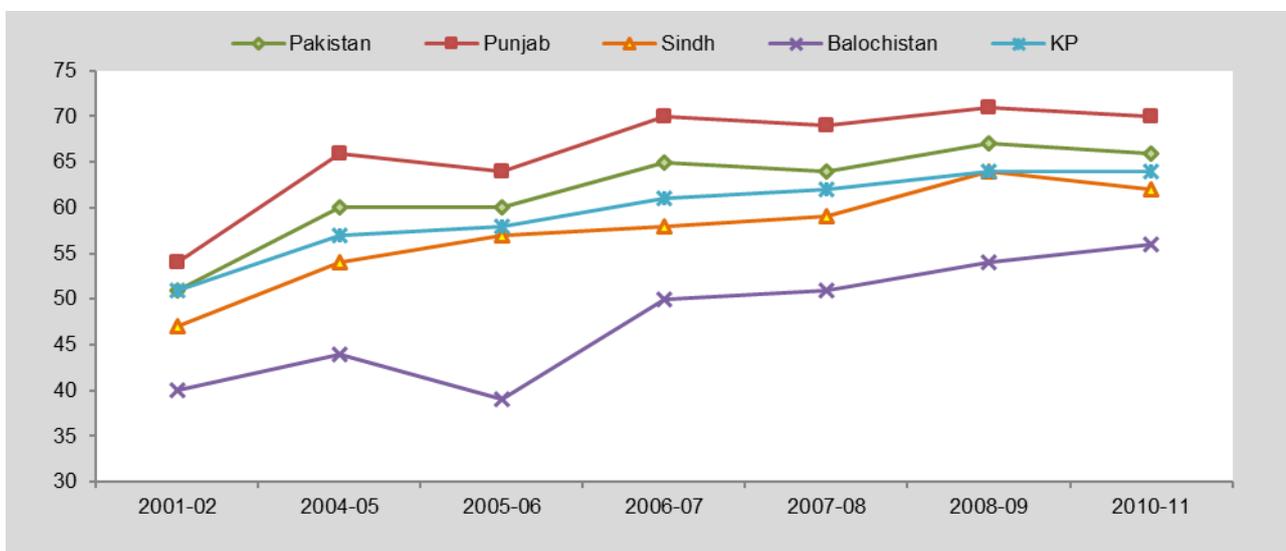
Figure 2.2 Net Enrollments by Age Cohort



Source: PSLMS

2.12 KP's NER for 6 to 10 year-olds is the lowest of all Pakistan provinces over the last 10 years—by 13 percentage points (Figure 2.3). The highest growth rate occurred in Punjab and Balochistan, where the NERs for both provinces were 16 percentage points, and Sindh, where it rose by 15 percentage points. Nationally, the NER average grew from 51 percent to 66 percent. Punjab's was consistently higher than Pakistan's, going from 54 percent to 70 percent in the 10 years to 2011. Khyber Pakhtunkhwa NER grew from 51 percent to 64 percent, and Sindh's from 47 percent to 62 percent. NER growth among 6 to 10 year-olds in all provinces, other than Balochistan, stagnated towards the end.

Figure 2.3 Net Enrollment Rates, by Province (Ages 6-10 years)

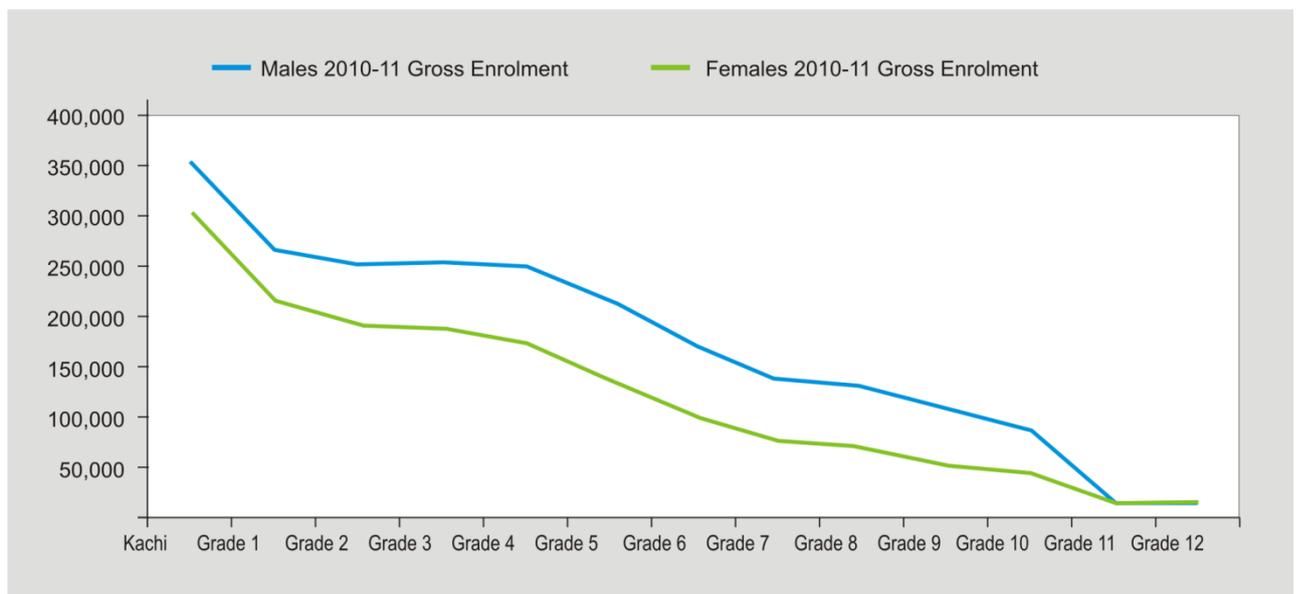


Source: PSLMS

2.13 Conflict, violence and natural disaster in KP in recent years have harmed education services. Any assessment of the development trajectory of KP must take account of important events beyond the control of government, as these have harmed public services, especially the education sector. In the last 10 years, KP has been severely affected by overlapping crises of violence in the form of terrorism and natural disasters in the form of the 2005 earthquake, and disastrous flash floods of 2010. The province is close to the federally administered tribal areas where the Pakistan military and insurgents continue to wage war. More importantly, KP's proximity to Afghanistan—the major player in the war on terror—leads to instability. Violent conflict has undermined the provision of education in three important ways: (i) schools have been shut down or damaged in conflict areas, for years in some cases. Some districts have 20-30 percent of teaching posts unfilled;¹⁹ (ii) the July 2010 floods had a highly disruptive effect on the education system of the province.²⁰ A Rapid Damage Assessment²¹ found that almost 297 public schools in KP were completely destroyed by the water and 671 partially damaged, putting thousands of children out of school. Many families lost the means to send their children to school, or needed the children to help with reconstruction efforts; and, (iii) the provincial government had to restructure its budget, diverting resources that had been earmarked for the 2011 Annual Development Plan, into flood compensation and rehabilitation.

2.14 Gross enrollment in KP schools tends to drop steepest before grade one. After dropping out in high numbers between kachi and grade one, students tend to stay on in primary school. They tend to drop out again in greater numbers around class five, then leave at a slower rate until grade 10 (Figure 2.4). The trend is fairly consistent in both genders. The gender gap increases slightly up to class five, narrowing thereafter with the smaller overall enrollment numbers. KP's Education Information Management System (EMIS) data also shows a sudden drop in enrollment between grades 10 to 11, especially for males. Since the data does not record the actual number of students in the last two years of secondary education who go on to study in colleges, the actual dip may be less significant.

Figure 2.4 Grade wise Break Down of Gross Enrollment by School Grade (KP)



Source: EMIS 2011

¹⁹ Government of KP, Comprehensive Development Strategy, 2009-2015.

²⁰ UNICEF, *Analysis of School Damage in Flood Emergency, KP*, 2010.

²¹ UNICEF, *KP Rapid Assessment Report*, September, 2010.

2.15 Poverty is a big factor in accessibility to schooling. Twelve percent of households say that education is too expensive, and there is a 37 percent difference between school participation of 6 to 10 year-olds in the first and fifth quintiles. The difference is even greater among 11 to 15 year-olds. However, comparison with Punjab shows that for all quintiles of population and for most age cohorts, school participation is lower in KP in both the public and private sector (Table 2.2). This indicates that demand- and supply-side factors other than socio-economic status play a role.

Table 2.2 Public and Private Sector Participation across Asset Quintiles

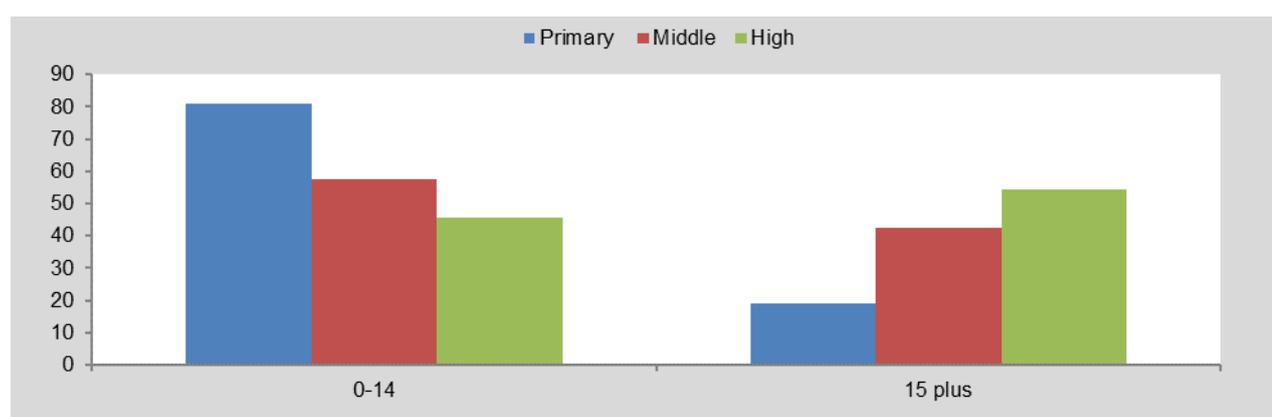
| | Khyber Pakhtunkhwa | | | | Punjab | | | |
|---------------|--------------------|----------|----------------|----------|--------------------|----------|----------------|----------|
| | Public and Private | | Private Sector | | Public and Private | | Private-Sector | |
| | 6 to 10 | 11 to 15 | 6 to 10 | 11 to 15 | 6 to 10 | 11 to 15 | 6 to 10 | 11 to 15 |
| <i>First</i> | 46 | 43 | 2 | 2 | 54 | 36 | 9 | 5 |
| <i>Second</i> | 58 | 59 | 6 | 4 | 78 | 60 | 18 | 10 |
| <i>Third</i> | 66 | 68 | 13 | 10 | 88 | 73 | 29 | 17 |
| <i>Fourth</i> | 74 | 79 | 28 | 19 | 94 | 84 | 47 | 26 |
| <i>Fifth</i> | 81 | 88 | 55 | 43 | 97 | 91 | 67 | 45 |

Source: PSLM

2.16 Children stay away because of poor school environment. A child's unwillingness to go to school is the most prevalent reason cited by 18 percent of the households for low enrollment, according to PSLM data. This is an indictment of the quality of schools, even though quality is rarely cited specifically. In 17 percent of the households, parents do prevent their children from going to school. Only 0.6 percent of households gave poor quality of schooling and 0.7 percent gave teacher shortages as reasons for low enrollment. Nearly 14 percent of households say their children do not go to school because they are too young or too old. As noted above, some 12 percent identify the cost of education as too expensive. In another 8 percent of households, children are unable to attend school because they have to help with housework.

2.17 Most households have a primary school close by (Figure 2.5). Only 6 percent of households say their children do not go to school because it is too far away. Up to 80 percent of households live no more than 14 minutes from a primary school, nearly 60 percent are in the same proximity to a middle school and 45 percent are close to a high school. Time taken for girls is likely to be higher because of the relatively smaller number of females schools.

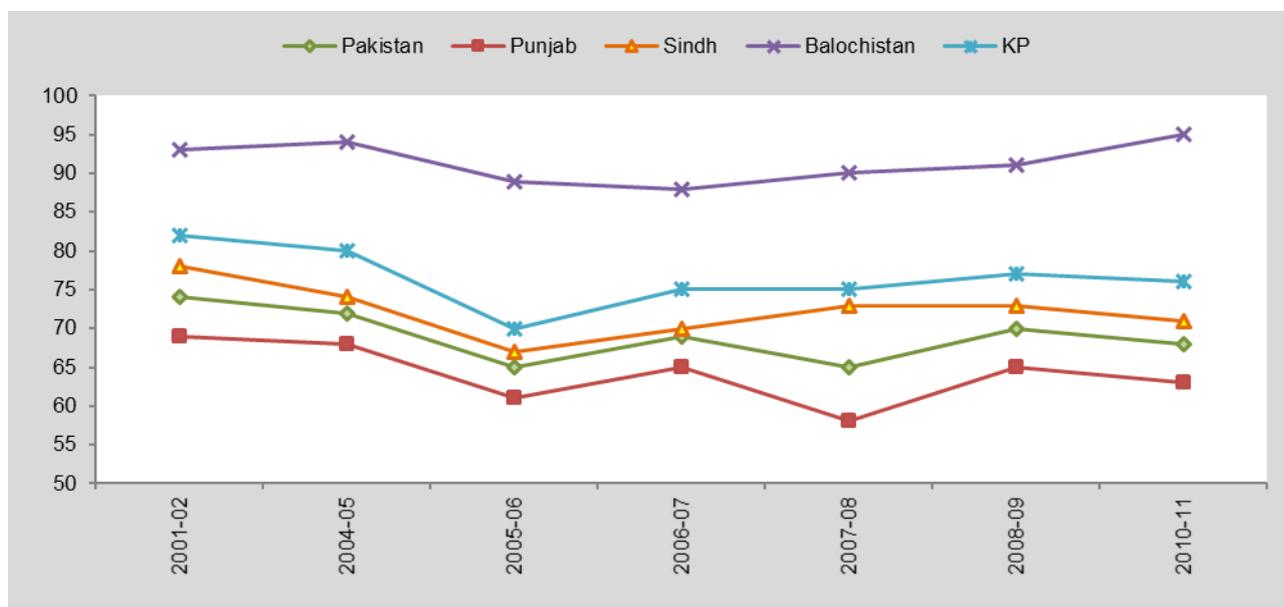
Figure 2.5 Time (in minutes) Taken to Reach School (KP)



Source: PSLMS 2010-11

2.18 Most school-enrolled children in KP are in public sector schools. The primary school enrollment rate in the public sector schools of KP is second highest after Balochistan (Figure 2.6). Of the students currently enrolled in academic institutions in KP, only 23 percent are in private schools, 74 percent are in public schools and only 3 percent in madrassa (see Box2.2 for more discussion on madrassas in KP). The role of the private sector, though relatively small compared with Sindh Urban or Punjab, is nonetheless substantial (Table 2.2). KP's EMIS calculates private sector enrollment growth at 6 percent annually against 2 percent of public sector school enrollment.

Figure 2.6 Primary Enrollment in Government Schools (% of Total Primary Enrollment)



Source: PSLMS 2010-11

Box 2.2 Unpacking the Madrassa Myth

Education system in Pakistan, especially in KP, is often seen from the prism of rising extremism. A typical view is that madrassas (religious seminaries) are a first choice of schooling in areas where other sources of schooling are limited, especially amongst households belonging to lower-income households within villages.

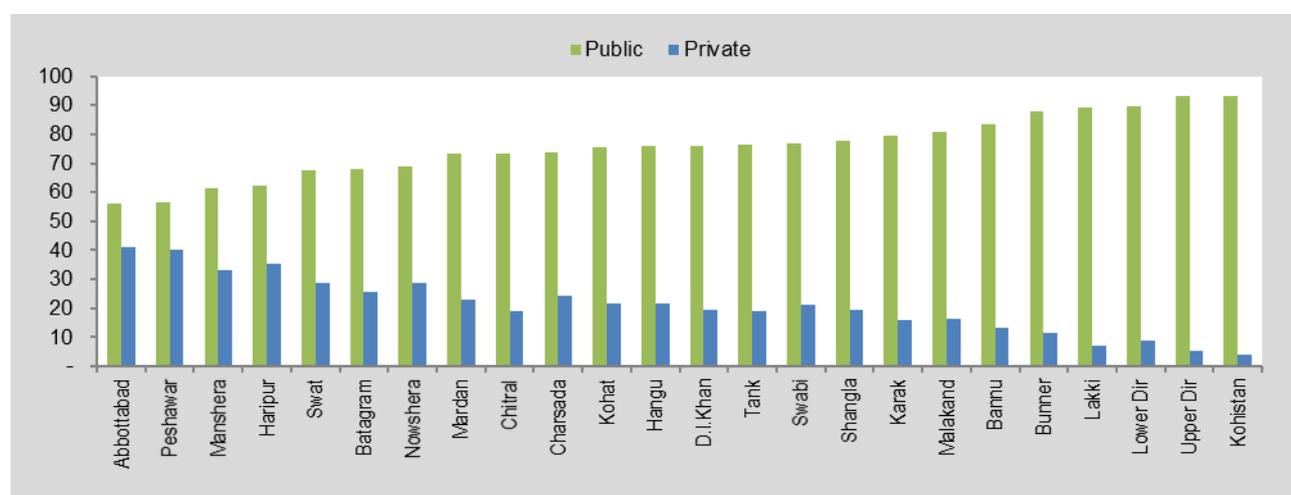
A recent paper by Andrabi et al (2012) argues that the 'data does not support this myth'. Districts in KP and Balochistan have a much higher prevalence of madrassas compared to the rest of Pakistan, but the absolute differences are small. Significant change in the education landscape in Pakistan are characterized by a rise in private schooling, not the proliferation of madrassas. Since 2000, the growth in the number of private schools is 70 percent higher than that of madrassas. In KP, approximately 75 percent of students are enrolled in public schools and private schools account for almost 22 percent of the enrolment. Enrolment in madrassas is less than 3 percent (PSLMS 2010-11). The data depicts a relatively stable but low per capita demand for this type of education independent of social and economic conditions.

Andrabi et al (2012) argue that the emphasis of debate should be on public schools facilitating development of private schools and not the role of madrassas. From the point of view of citizens of KP, this appears to be an irrelevant option. In addition, there is a potential of expanding the groups of moderately educated women at the local level to ensure growth of the private sector. Finally, there is a need to improve quality of public sector schools in KP particularly by improving the governance.

Source: Andrabi, T., Jishnu Das, AsimljazKhawaja . (2012). Madrassa Statistics Don't Support the Myth. In Bashir, S. and Crews, R. Under the Drones: Modern Lives in the Afghanistan-Pakistan Borderlands. USA: Harvard University Press. 162-173.

2.19 Availability of private schools varies across districts, being far lower than that of public schools in some districts (Figures 2.7). In relatively remote districts of Kohistan, Upper Dir and Lower Dir, private school numbers are low. Unlike in Punjab, where a low-cost private sector is widespread even in rural areas, the KP government cannot bank on the private sector, as of now, to deliver services in many disadvantaged districts for the foreseeable future.

Figure 2.7 Availability of Public and Private Schools



Source: PSLMS 2010-11

2.20 Illiteracy is high in KP, especially among rural females. KP literacy rates are also substantially behind the national average, having stayed at an average of 50 percent for the last three years. Only 29 percent of females in KP are literate; better than in rural Sindh or Balochistan, but 13 percent below those in Punjab and 5 percent beneath the national average.

Table 2.3 Literacy Among People 10 Years and Older (by Region and Province)

| Region/Province | 2008/09 PSLMS | | | 2010/11 PSLMS | | |
|--------------------|---------------|-----------|-----------|---------------|-----------|-----------|
| | Male | Female | Total | Male | Female | Total |
| Urban Areas | 81 | 67 | 74 | 81 | 67 | 74 |
| Punjab | 82 | 71 | 76 | 80 | 71 | 76 |
| Sindh | 81 | 65 | 73 | 82 | 68 | 75 |
| KP | 76 | 48 | 62 | 77 | 50 | 63 |
| Balochistan | 78 | 47 | 64 | 79 | 40 | 61 |
| Rural Areas | 63 | 33 | 48 | 63 | 35 | 49 |
| Punjab | 61 | 39 | 43 | 64 | 42 | 53 |
| Sindh | 67 | 27 | 47 | 60 | 22 | 42 |
| KP | 67 | 27 | 47 | 67 | 29 | 48 |
| Balochistan | 57 | 16 | 38 | 54 | 13 | 35 |
| Overall | 69 | 45 | 57 | 69 | 46 | 58 |
| Punjab | 69 | 50 | 59 | 70 | 51 | 60 |
| Sindh | 71 | 45 | 59 | 71 | 46 | 59 |
| KP | 69 | 31 | 50 | 68 | 33 | 50 |
| Balochistan | 62 | 23 | 45 | 60 | 19 | 41 |

Source: PSLMS 2008-09 and 2010-11

2.21 All teachers have minimum qualifications. The qualification of teachers appears not to be an issue (Table 2.4). All teachers in KP, as in other provinces, have minimum qualifications, although they may not have received formal pedagogical training, especially in new interactive methods of teaching, according to ESP.

Table 2.4 Percentage of Trained Teachers

| Region/ Province | FY2009 | | FY2010 | | FY2011 | |
|------------------|----------|--------|----------|--------|----------|--------|
| | Primary* | Middle | Primary* | Middle | Primary* | Middle |
| Pakistan | 97 | 98 | 95 | 91 | 95 | 91 |
| Punjab | 100 | 100 | 95 | 88 | 94 | 87 |
| Sindh | 92 | 94 | 92 | 96 | 94 | 96 |
| KP | 100 | 100 | 100 | 100 | 99 | 100 |
| Baluchistan | 99 | 94 | 99 | 97 | 99 | 97 |

Source: Pakistan Education Statistics 2009-10 & 2010-11, AEPAM, MoP&TT, Islamabad

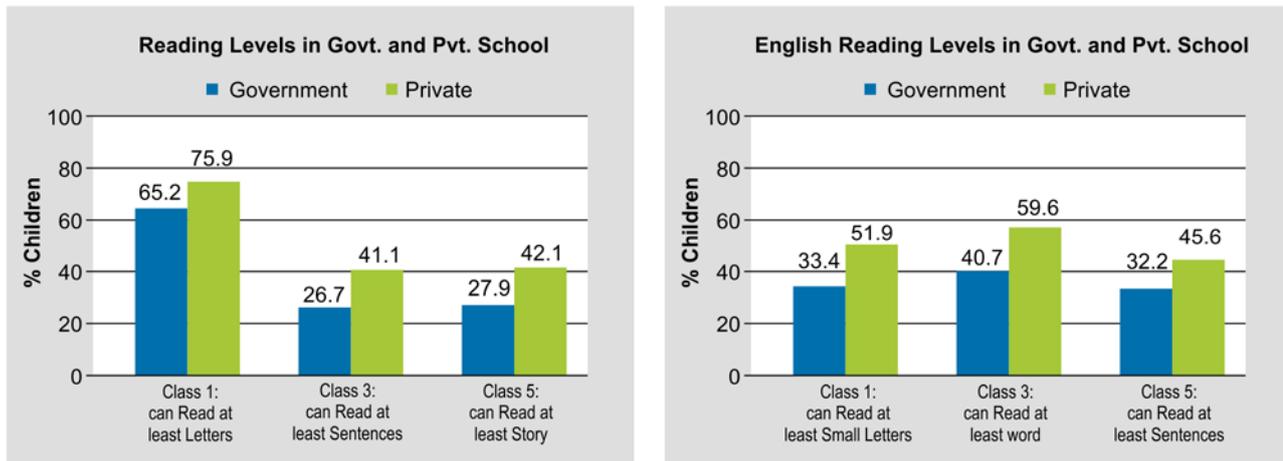
*including mosque schools.

2.22 Quality of education and learning outcomes in KP follow the national trend of low learning. The National Education Assessment System Report of 2008 found students in KP no more proficient in mathematics and language at the primary level than those in the rest of Pakistan. In fact they lagged behind their counterparts in Punjab (Table 2.5). Use of Pushto as the medium of instruction in several districts may have contributed to low Urdu scores. Students in Grade 8 were less knowledgeable in science and social studies than the national average. Recent national surveys, such as one carried out by Pakistan Annual State of Education Report (ASER), confirmed the trends noted by the National Education Assessment System. Learning levels in KP are low, although there are interesting variations: the report identifies boys outperforming girls in English, Mathematics and Urdu, and performance in private schools is better in English, Mathematics and Urdu.

Table 2.5 KP vs. Rest of Pakistan: Performance in Language and Mathematics (Grade 4)

| Province | Language Reading (scaled Mean Score) | | | Language Writing (scaled Mean Score) | | | Mathematics (Scaled Mean Score) | | |
|-------------|--------------------------------------|------------------|------------|--------------------------------------|------------------|------------|---------------------------------|------------------|------------|
| | Province | Rest of Pakistan | Difference | Province | Rest of Pakistan | Difference | Province | Rest of Pakistan | Difference |
| Balochistan | 372 | 377 | n.s | 402 | 501 | Sig. | 362 | 369 | n.s |
| KP | 370 | 378 | n.s | 455 | 503 | Sig. | 388 | 346 | n.s |
| Punjab | 402 | 348 | Sig. | 543 | 447 | Sig. | 388 | 346 | Sig. |
| Sindh | 330 | 393 | Sig. | 444 | 517 | Sig. | 324 | 385 | Sig. |

Source: Adapted from the National Education Assessment System Report, 2008

Figure 2.8 Reading Levels in Private and Public Schools

Source: ASER 2011

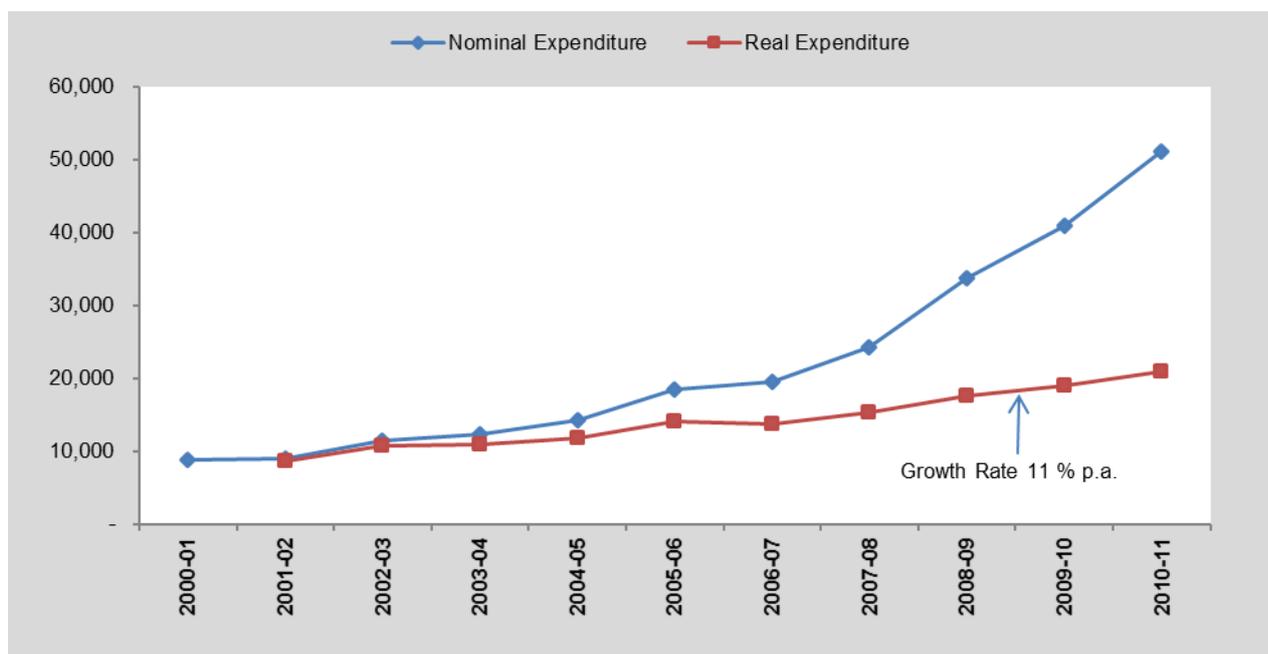
2.23 The majority of KP households are 'satisfied' with schools. KP education indicators of access to and quality of schools may be poor, but citizens seem to be unaware about it. In KP, 65 percent of households were satisfied with schools, according to PSLMS (2011)—the highest of any province, and four points higher than the national average. KP households were also more satisfied with schools than with any of the other five facilities and services surveyed—basic health units (BHUs), family planning, veterinary services, agriculture extension and police. Furthermore, their level of satisfaction was almost twice that of the next-best service (BHUs), at 35 percent. The figures suggest that parents are quite uninformed about schooling quality and appear to equate proximity of schools—between 45 percent and 80 percent live within a walking distance from a school—with good service. Balochistan has the lowest satisfaction level, mainly due to vastly lower satisfaction levels of rural households. Generally, urban satisfaction levels are 10 percent higher than rural levels in the other three provinces, including KP, suggesting that dissatisfaction is related to absence of nearby schools, rather than schooling quality.

2.24 Education MDGs will be difficult to meet with current trajectory of financing and governance arrangements. KP has made modest improvements in primary enrolment and school completion, literacy rates and secondary level gender parity, but the current rate of growth, especially given the recent stagnation particularly at primary level, is not going to help KP meet the MDG goals in 2015. As discussed subsequently, more funding, though always useful, will not solely help KP achieve these goals. Composition and targeting of funds and most importantly, governance of public sector schools shall have to change markedly to revitalize the current anemic growth path of key MDG indicators.

2.4 Trends in Education Expenditure

Adequacy of Budget Allocations

2.25 Education expenditure in KP has been growing at double-digit rates over the last ten years, with a substantial share increasingly allocated to development. In real terms, total expenditures have grown at an average annual rate of 11 percent. However, total nominal expenditures have risen at an average rate of 20 percent per annum.

Figure 2.9 Total Public Sector Education Spending

Source: PIFRA

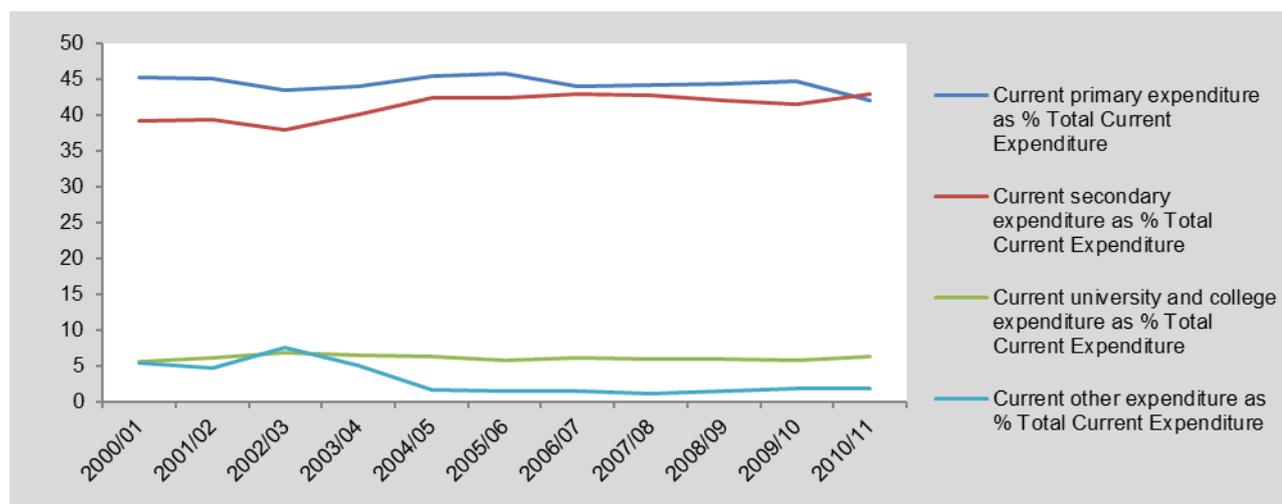
2.26 KP's fiscal emphasis on education is not fundamentally different from that of other provinces. KP's emphasis on education is about the same as that of Punjab, the best performing province. KP spends around 26 percent of its current budget on education, more than Sindh.

Table 2.6 Relative Education Expenditures, 2011

| | Punjab | Sindh | KP | Balochistan | Pakistan |
|--|---------|---------|---------|-------------|-----------|
| Total Current Budget (Millions) | 525,986 | 359,917 | 197,220 | 92,602 | 1,175,724 |
| Education Current Budget (Millions) | 140,162 | 72,395 | 51,030 | 19,409 | 282,995 |
| Education as Percent of Provincial Current Expenditure | 27 | 20 | 26 | 21 | 24 |
| Primary as a percent of education expenditure | 48 | 44 | 35 | 38 | 44 |
| Secondary | 36 | 25 | 45 | 34 | 35 |
| Tertiary | 11 | 17 | 18 | 16 | 14 |
| Others | 5 | 15 | 2 | 11 | 7 |

Source: PIFRA

2.27 KP's sectoral priorities are very different from those of other provinces. Intra-education current expenditures show primary education is losing out. KP expenditures on primary education relative to total education expenditure are the lowest in Pakistan—15 percentage points less than the share allocated to primary education in Punjab. On the other hand, KP's secondary education allocation share is the highest in the country—nine percent more than Punjab's. Relative current expenditure on secondary education increased through the 2000s, while the share for primary education has fallen (Figure 2.10). Both secondary and tertiary education sectors have swelled their shares of current expenditure in this time.

Figure 2.10 KP Shares of Education Current Expenditure (%)

Source: PIFRA

2.28 Relative sub-sector education spending across provinces show differing priorities. Spending share patterns in subsectors of education at the national level for total current and development funding in 2009-11 were fairly constant (Table 2.7). KP and Balochistan gave a greater percentage to secondary and tertiary education than the other provinces, while KP allocated a smaller of total current and development expenditures to primary education than did Sindh and Punjab. The correlation between expenditure and enrollment numbers is hard to pin down, but the relative performance of KP's primary and secondary sectors appears to have followed spending patterns.

Table 2.7 Percentage Distribution of Education Sector PRSP Expenditures by Province and Subsector

| | Federal | Punjab | Sindh | Balochistan | KP | Total |
|---------------------------------------|---------------|--------|-------|-------------|-------|-------|
| Education Sub-sector | FY2011 | | | | | |
| Primary Education | 7.04 | 498 | 35.19 | 23.12 | 29.48 | 31.18 |
| Secondary Education | 9.9 | 26.52 | 25.92 | 32.97 | 31.49 | 24.15 |
| Universities, Colleges and Institutes | 71.65 | 9.65 | 14.29 | 34.41 | 15.93 | 24.65 |
| Teachers Training, TVET and Others | 11.42 | 22.85 | 24.59 | 9.5 | 23.1 | 202 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |
| Education Sub-sector | FY2010 | | | | | |
| Primary Education | 7.22 | 41.17 | 36.75 | 37.26 | 33.7 | 33.23 |
| Secondary Education | 9.5 | 25.14 | 26.08 | 39.9 | 27.58 | 24.97 |
| Universities, Colleges and Institutes | 69.8 | 174 | 15.66 | 15.45 | 13.92 | 23.2 |
| Teachers Training, TVET and Others | 13.47 | 22.95 | 21.51 | 7.39 | 24.8 | 18.6 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |
| Education Sub-sector | FY2009 | | | | | |
| Primary Education | 6.2 | 37.64 | 471 | 38.01 | 34.9 | 32.4 |
| Secondary Education | 8.52 | 24.21 | 29.24 | 38.88 | 31.64 | 24.68 |
| Universities, Colleges and Institutes | 74.73 | 9.99 | 17.23 | 15.91 | 14.57 | 24.43 |
| Teachers Training, TVET and Others | 155 | 28.66 | 12.82 | 7.2 | 18.89 | 18.49 |
| Total | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Strengthening PRS Monitoring, Finance Division, Islamabad, 2011

2.29 KP's expenditure per student on public primary schools is the lowest in the country (Table 2.8). Its spending per student is almost half of Punjab's. On the other hand, KP's secondary school expenditures—both current and development—are the highest in Pakistan. Punjab and Sindh per student spending may be inflated, as it includes substantial private sector support by provincial education foundations in the primary education budget. However, the primary sub-sector in KP is not getting enough resources, even by standards of other provinces.

Table 2.8 Per Student Expenditures, 2011

| Per Student Annual Expenditure 2010-11 (Rs) | Baluchistan | Punjab | Sindh | KP |
|---|-------------|--------|-------|-------|
| Primary | | | | |
| Current | 12329 | 14829 | 9001 | 6090 |
| Development | 544 | 255 | 734 | 404 |
| Total | 12873 | 15084 | 9735 | 6495 |
| Secondary | | | | |
| Current | 13761 | 7392 | 15220 | 17487 |
| Development | 598 | 1044 | 887 | 5698 |
| Total | 14359 | 8436 | 16108 | 23184 |

Sources: PIFRA and Provincial Education Census Reports

2.30 The secondary education spending share may be underreported because a substantial part of spending allocated to tertiary education, perhaps half, is actually devoted to secondary education for the first and second years of college, that are in effect higher secondary classes. KP's share for tertiary education is already the highest in the country. The fact is that KP spends substantially more on secondary schooling—over 50 percent of all education expenditure—than on primary schooling. This contrasts sharply with other provinces.

2.31 Funds may have increased substantially over the years but are still far from adequate to meet development needs. About one third of schools do not have water; one half does not have electricity; and, close to one quarter do not have boundary walls or latrines. The slow accretion of needed facilities at school reflects the inadequacy of resources, lack of investment, and low development allocations. Government school facilities suffered massive damage in the 2005 earthquake; proportionally more than private buildings. At current funding rates, it will take another six to ten years, depending upon the state of facilities, to provide basic facilities to all schools (Table 2.9).

Table 2.9 KP Budget Allocations to School Facilities

| | 2011 | 2010 | 2009 |
|------------------|------|------|------|
| Primary | | | |
| Electricity | 50.9 | 53.9 | 56.6 |
| Boundary | 30.4 | 32.8 | 35.6 |
| Playground | 75.5 | 75.8 | 78.6 |
| Latrine | 27.3 | 30.2 | 32.4 |
| Secondary | | | |
| Electricity | 22.1 | 23.9 | 25.6 |
| Boundary | 18.6 | 21.6 | 25.8 |
| Playground | 72.2 | 71.6 | 72.7 |
| Latrine | 10.6 | 12.4 | 16.0 |

Source: EMIS

2.32 Teacher and classroom spread shows constrained resources in schools. Most KP primary schools have two classrooms and two teachers. At the primary level in 2011, 13 percent of boys' schools and 9 percent of girls' schools had six or more classrooms (Table 2.10). A total of 13 percent of boys' schools and 14 percent of girls' schools had six or more teachers. Few schools had just one or no classroom at all; 24 percent of boys' schools and 18 percent of girls' schools had only a single teacher.

Table 2.10 KP Distribution of Primary Classrooms and Teachers, 2011

| | Classrooms | | Teachers | |
|--------|-------------------|--------------------|-------------------|--------------------|
| | % of Boys Schools | % of Girls Schools | % of Boys Schools | % of Girls Schools |
| 0 | 1.34 | 0.08 | 0.07 | 0.15 |
| 1 | 7.82 | 0.87 | 24.13 | 18.06 |
| 2 | 48.16 | 59.38 | 33.13 | 41.40 |
| 3 | 13.21 | 14.66 | 14.58 | 12.96 |
| 4 | 11.01 | 10.03 | 9.30 | 8.07 |
| 5 | 5.49 | 6.13 | 5.88 | 5.23 |
| 6 Plus | 12.98 | 8.87 | 12.92 | 14.12 |

Source: EMIS

2.33 Despite efforts to upgrade infrastructure, building more classrooms and enhancing teacher provision, major gaps persist, which suggest insufficient funding for basic primary school infrastructure. Investments need to be enhanced substantially to meet these urgent needs.

2.34 Pressure to improve facilities at existing schools has increased. The KP school system has developed a large infrastructure over the last several decades. Over the last 10 years, the government's emphasis on constructing new schools has shifted towards improving facilities at existing schools. More than 75 percent of schools were constructed between 10 and 30 years ago, but over the last 10 years, construction has totaled just 7 percent of the schools.²²

2.35 Non-teaching education sector staffing has accelerated in recent years. The number of non-teaching staff has increased by 15 percent at the primary level and 12 percent at the secondary level. Considering the shortage of teachers, this trend indicates non productive allocation of resources. The districts of Dir Payan, Peshawar, Nowshera and Kohistan accounted for 55 percent of the total increase in non-teaching positions over the last three years in KP, while there was a decline in non-teaching positions in the districts of Swat, Karak, Shangla, Hangu and DI Khan.

Getting More Value for Money

2.36 The biggest challenge will be in getting more value for money already being spent, especially given the fact that teachers' salaries, like those of other provincial governments, is the single biggest recurrent expense of the provincial exchequer. Sustained double digit increases in real funding for the sector over the last ten years have not translated into matching gains in enrollment or quality. Though no specific evidence of teacher effort and absenteeism rates exist for KP, the ESP notes that the situation is similar to other parts of Pakistan. In addition to massive leakages of public funds because of this 'soft corruption', development funds on construction of school facilities appear to suffer similarly from large leakages.

²² Source: ESP 2008

2.37 Operational funds are miniscule and declining. Employee-related expenditures amounted to 98 percent of total current expenditures in the primary subsector in 2011, having risen by 1 percent over the last three years (Table 2.11). Operating expenses declined to just 1.1 percent in 2011, from 1.4 percent in 2009, partly reflecting the substantial rise in wage bill because of salary increases. The share of secondary non-salary funds is bigger than that of primary, but also declining, having almost halved in the last three years. These low non-salary allocations are clearly insufficient to meet the day to day needs of schools contributing to low quality.

Table 2.11 Trend in Distribution of KP Current Educational Expenses

| Primary | | 2008-9 | 2009-10 | 2010-11 |
|------------|--------------------|--------|---------|---------|
| Salary | | 96.6 | 97 | 97.9 |
| Non-salary | OPERATING EXPENSES | 1.4 | 1.2 | 1.1 |
| Others | | 2 | 1.8 | 1 |
| Secondary | | 2008-9 | 2009-10 | 2010-11 |
| Salary | | 93.8 | 95.3 | 96.7 |
| Non-salary | OPERATING EXPENSES | 2.9 | 2.4 | 1.6 |
| Others | | 3.4 | 2.3 | 1.7 |

Source: PIFRA

2.38 The provincial government makes all the decisions. Primary and secondary expenditures, mainly salaries payments, are much higher at district level than at provincial level. Since 2010, provincial salary expenditures, particularly at the secondary level, have fallen and non-salary expenditures have risen sharply (Table 2.12). The districts barely have any planning function other than paying salaries. The non-salary primary provincial budget is also relatively high since budgets for parent teacher councils, which work at school level, are funded by the provincial government.

Table 2.12 Provincial and District Current Expenditure—Relative Responsibilities

| | KP Total | | | District Functions | | | KP Provincial Functions | | |
|----------------------|----------|---------|---------|--------------------|---------|---------|-------------------------|---------|---------|
| | 2008-09 | 2009-10 | 2010-11 | 2008-09 | 2009-10 | 2010-11 | 2008-09 | 2009-10 | 2010-11 |
| Primary Total Budget | 10,995 | 13,022 | 16,916 | 10,588 | 12,915 | 16,777 | 90 | 107 | 138 |
| Salary (%) | 96.64 | 96.96 | 97.94 | 99.54 | 96.96 | 97.96 | 95.82 | 96.02 | 95.72 |
| Non-Salary (%) | 3.36 | 3.04 | 2.06 | 46 | 3.04 | 2.04 | 4.18 | 3.98 | 4.28 |
| Secondary | 10,475 | 17,358 | 17,262 | 10,450 | 12,101 | 17,196 | 25 | 27 | 71 |
| Salary (%) | 93.55 | 95.13 | 96.26 | 93.56 | 95.14 | 96.46 | 89.58 | 91.07 | 47.62 |
| Non-Salary (%) | 6.45 | 4.87 | 3.74 | 6.44 | 4.86 | 3.54 | 142 | 8.93 | 52.38 |

Source: PIFRA

2.39 Education figures prominently in district governments' non-discretionary spending, but is accorded a low priority in discretionary spending. The devolution plan of 2001 granted all day-to-day administration and development planning in primary and secondary education to the districts. Education, being the biggest employer, consumes about 68 percent of the current budget of all KP districts in recent years (Table 2.13). Since tertiary and

other sub-sectors of education were not devolved to districts, this spending is for primary and secondary schools only, with the split being roughly equal, although the share of secondary education appears to be rising. Districts get far less discretionary development funding than the province. While education expenditures take up most of the districts' spending as non-discretionary salary payments. Where districts have discretion—how much to allocate to education from within their discretionary development budget—the share of education is small and decreasing: only 1 percent in 2011. This could be due to district planners being less interested in education than more popular services such as water and sanitation, farm-to-market roads, or electricity linkages. Or it could be that provincial government has taken over development expenditure on education, and districts do not feel the need to spend much on this sector.

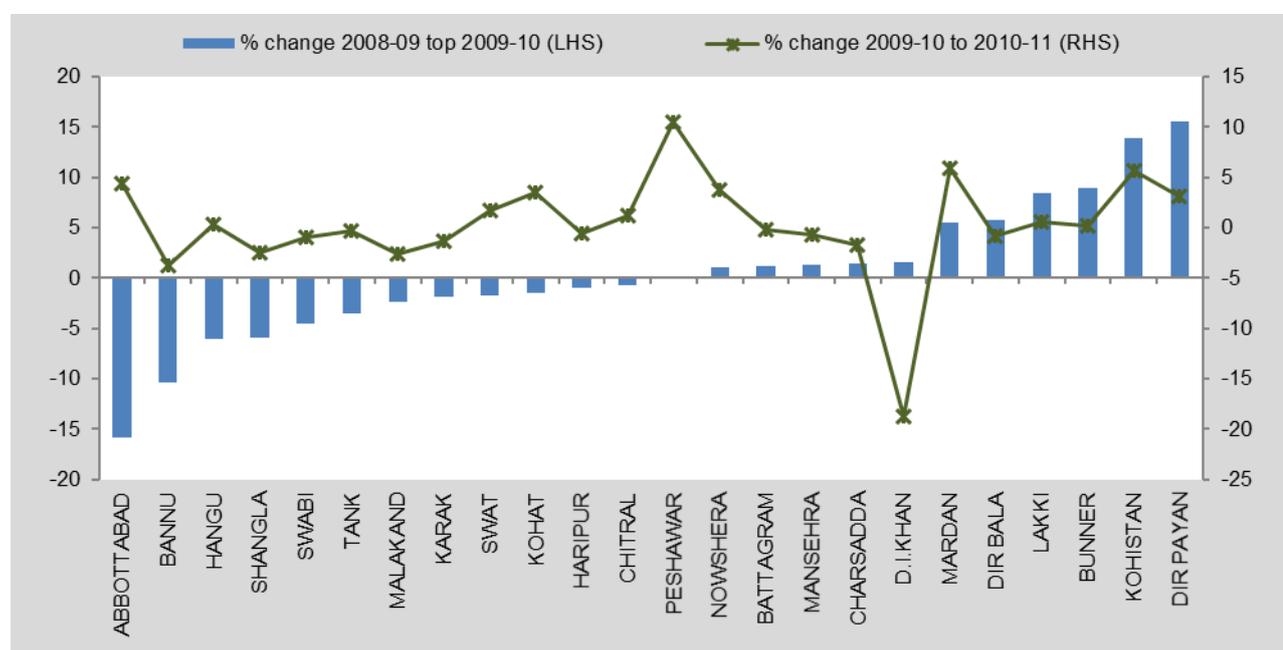
Table 2.13 District Education Expenditure Trends

| Education as a share of District Budgets | 2007/8 | 2009/9 | 2009/10 | 2010/11 |
|---|--------|--------|---------|---------|
| Total Current District Budget (millions) | 29,829 | 31,966 | 36,705 | 49,921 |
| Education (%) | 66 | 69 | 69 | 68 |
| Primary (%) | 49 | 50 | 51 | 49 |
| Secondary (%) | 48 | 47 | 48 | 50 |
| Total Development District Budgets (millions) | 2,282 | 1,232 | 1,775 | 2,807 |
| Education (%) | 3 | 6 | 1 | 1 |
| Primary (%) | 42 | 74 | 51 | 84 |
| Secondary (%) | 18 | 5 | 49 | 16 |

Source: PIFRA

2.40 Some districts have received more resources than others. While the number of teaching and non-teaching staff in KP has risen over the last three years, as noted above, these resources are not distributed uniformly across districts—as they should be, given the variance in education indicators. The mountainous poor districts of Kohistan, Dir Payan and Buner have been assigned a significantly higher number of teachers and non-teaching staff.

Figure 2.11 Annual Fluctuations in Primary Teaching Staff

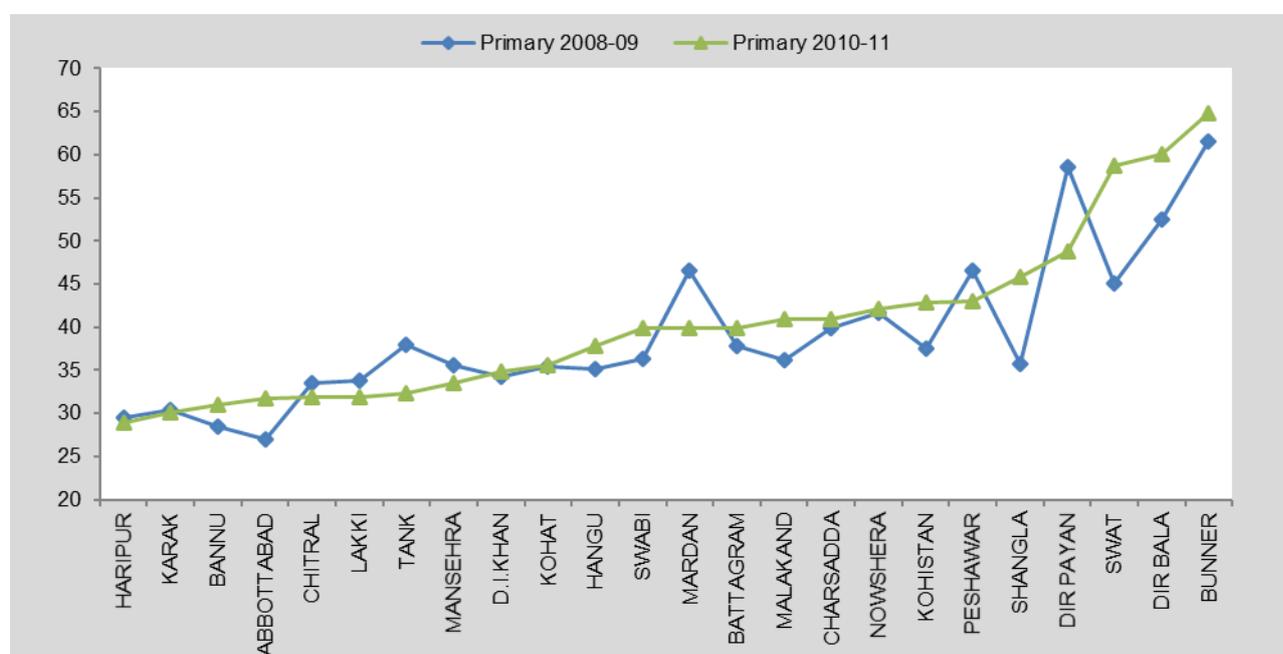


Source: EMIS 2011

2.41 Over the last three years, student-teacher ratios (STRs) have been increasing, though slowly. STRs have risen marginally at both primary and secondary levels. Given the low increase in the number of teachers over the three-year period 2009-11, this increase can likely be attributed to increasing enrollment. While there is no firm evidence that low STRs necessarily lead to better learning, crowded multi-grade classrooms—as appears to be the case in many districts—are going to handicap learning.

2.42 There are substantial inter-district STR disparities. The lowest STR for primary schools is at 30 for Haripur and highest is over 60 for Buner (Figure 2.12). The disparity for secondary education is even wider: lowest for Battagram at under 10 and highest for Mansehra at over 30. The gap seems to be widening for the least-endowed districts, particularly in primary education; the STR for Swat, Buner and DirBala has worsened over the three years—possibly because of the violent conflict in these areas. Districts with higher STRs in primary education may not necessarily fare the same in secondary education. For example, Battagram, with a relatively high primary STR has the lowest secondary STR.

Figure 2.12 Student Teacher Ratios—Primary Schools by District (2009 & 2011)



Source: EMIS 2010-11

2.43 Allocation of resources across boys' and girls' schools is more equitable than expected. The proportion of girls' schools with two teachers is higher than that of boys' schools. Likewise, the proportion of girls' schools with three classrooms is higher than the boys', as is the number of girls' schools with more than six teachers. This positive trend is in line with increasing focus on girls' education.

2.44 The government has successfully filled the gap of missing facilities at girls' secondary schools. KP has made major improvements to latrines and boundary walls in secondary schools. The number of boys' and girls' secondary schools with missing latrines and boundary walls dropped by 33.56 percent and 27.92 percent from 2008 to 2011 respectively. The corresponding numbers for primary schools fell 15 percent and 14.6 percent respectively. Since, the absence of boundary walls and latrines is a bigger issue for females; girls' schools have generally fared better in the upgrades. At the primary level, a significantly higher proportion of female schools have facilities such as latrines, boundary walls and playgrounds than male schools. At the secondary level, the difference between available facilities in male and female schools is less distinct.

2.45 Schools in rural areas are likely to have more resources. Rural schools are generally better endowed with resources than urban schools at both primary and secondary levels. At the secondary level however, the difference decreases. Urban areas are also relatively better endowed with female education facilities—having more schools and greater enrollment. The greater number of schools in rural areas explains this difference. In rural areas, except for the number of teachers and student classroom ratios, all other indicators show an increase, during 2009-11 (Table 2.14). The STR increased by almost 3 percent at the primary level and 6 percent at the secondary level in rural areas. This ratio falls, however, in urban areas.

Table 2.14 Urban and Rural Resource Endowments

| | % Change fiscal 2009-11 | | | |
|-----------------------------|-------------------------|-----------|---------|-----------|
| | Urban | | Rural | |
| | Primary | Secondary | Primary | Secondary |
| Number of Schools | (1.65) | 2.49 | 0.97 | 3.30 |
| Number of Female Schools | (2.10) | 3.26 | 1.63 | 6.55 |
| % Female Schools | (0.46) | 0.74 | 0.65 | 3.14 |
| Number of Students | 4.95 | 0.42 | 4.37 | 7.00 |
| Number of Female Students | 4.60 | (0.30) | 6.01 | 15.79 |
| % Female Students | (0.33) | (0.72) | 1.57 | 8.21 |
| Number of Teachers | 0.82 | 9.81 | (0.61) | 8.34 |
| Number of Non-teacher Staff | 134.45 | 8.20 | 129.79 | 12.98 |
| Number of Classrooms | 3.48 | 2.67 | 5.50 | 6.62 |
| STR | (0.25) | (8.98) | 2.56 | 6.04 |
| Student Classroom Ratio | 1.41 | (2.19) | (1.07) | 0.36 |

Source: EMIS

2.46 The relative decrease in urban STR for both primary and secondary schools probably reflects the practice that more teachers prefer to be assigned to urban areas, thereby indicating a less-optimal allocation of resources. Urban schools and teachers are however a small percentage of the total.

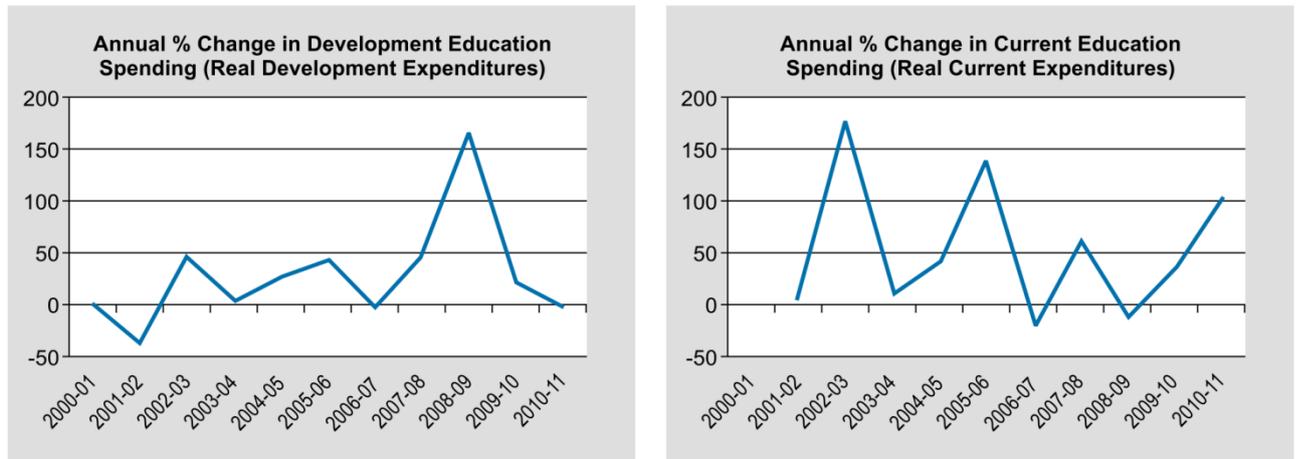
2.5 Planning and Governance

2.47 Despite increased funding, more and fully-qualified teachers, wide availability of schools, and improved facilities, access to schooling has stagnated and learning levels remain low. The gap between substantial expenditure and weak reality can be ascribed mostly to poor governance. KP's ESP identifies teacher absenteeism and poor management as key issues that plague the system.

2.48 Institutional arrangements are undergoing major changes. The Local Government Ordinance of 2001 gave provincial governments no role in day-to-day service delivery in primary and secondary education, delegating operational and development decisions to the districts. That, at least, was the de jure position; the reality was somewhat different, as provincial government provided the development funding for the subsector and made most of the scheme-level decisions. The recent changes to local government system will institutionalize the provinces' management of local education services.

2.49 On average, education expenditure has increased since 2001. However, on an annual basis the shifts in expenditure have been volatile, in both current and development expenditures (Figures 2.13). Current expenditures rose by 21 percent in 2002 and 2003, and development expenditures by over 200 percent in 2007 and 2008.

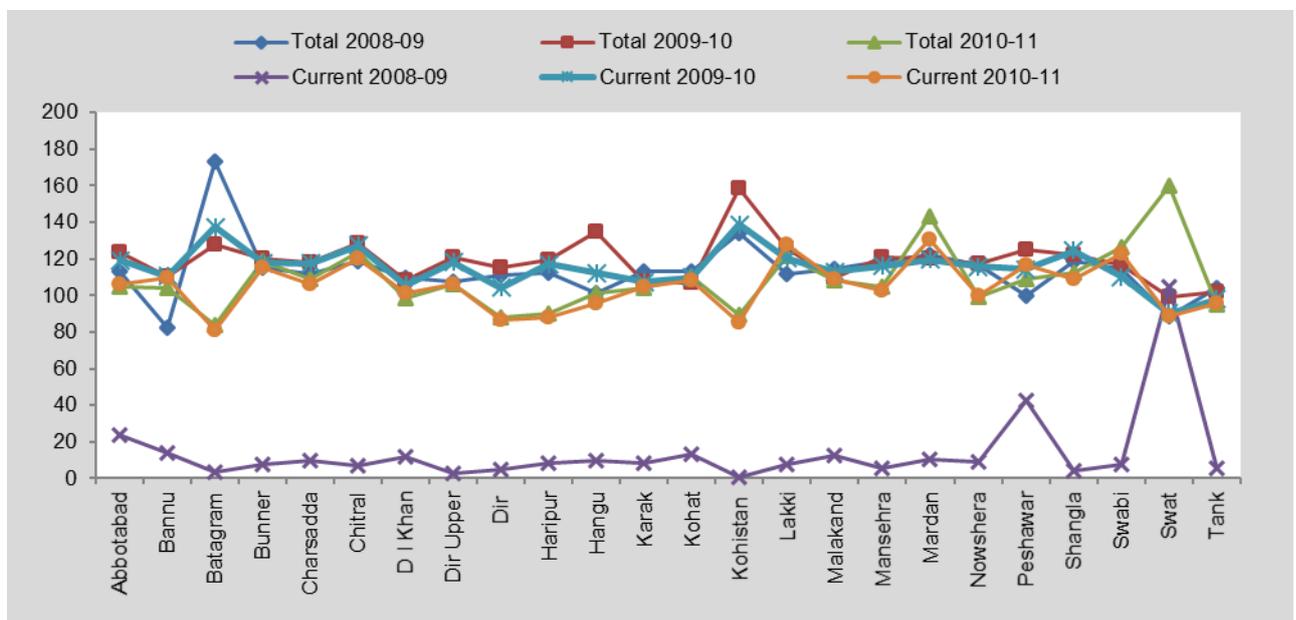
Figure 2.13 Education Development Spending and Current Spending



Source: PIFRA

2.50 Adhoc expenditure trends are common in KP, reflecting planning weaknesses (Figure 2.14). In recent years, education expenditures at district level have consistently exceeded allocations for education by more than 100 percent, on average. In 2009, current expenditures exceeded allocations by an average of 14 percent. However, the deficit in current expenditures also increased in 2010. In contrast, development expenditures exceeded allocations by an average of 3,000 percent in 2009, falling to 125 percent in 2010 and 2011. Such patterns in budget allocations and expenditures reveal ad hoc expenditure, which persist (partly explained by forced reallocation of resources due to floods) despite the formulation of education sector plan and the output-based budget.

Figure 2.14 Allocations and Expenditure Gap



Source: EMIS

2.51 Attempts have been made to link budget with outcomes in KP. Allocated resources and budgetary forecasts for outcomes through to 2014 show that tertiary education is emphasized, as is improved management and teacher training (Table 2.15). However, the goal of reducing dropouts at primary level and achieving universal primary education are scarcely funded.

Table 2.15 Budgetary Allocations for Outcomes

| Outcome Indicator | Original Budget | | Budget Estimates | | Medium Term Budget Forecast | | Forecast | |
|---|-----------------|---------------|------------------|---------------|-----------------------------|---------------|--------------|---------------|
| | FY 2011 | | FY 2012 | | FY 2013 | | FY 2014 | |
| | Recurrent | Development | Recurrent | Development | Recurrent | Development | Recurrent | Development |
| Increase in literacy rate and achieving universal primary education irrespective of culture, creed and gender | 1877.9 | | 1393.8 | | 1533.2 | | 1686.5 | |
| Desirous students admitted in professional and specialist education irrespective of gender, creed or race | 107.3 | 5019.2 | 20 | 5496.35 | 22.0 | 6046.0 | 24.2 | 6650.58 |
| Qualified teachers with upgraded quality of pre-service teachers training available in the market | 192.2 | 30.0 | 219.76 | 70 | 241.7 | 77.0 | 265.91 | 84.7 |
| Good Governance in the department because of trained education Managers | 213.8 | 188.2 | 305.44 | 154.85 | 336.0 | 170.3 | 369.58 | 187.37 |
| Total | 513.3 | 7115.2 | 545.2 | 7115.0 | 599.7 | 7826.5 | 659.7 | 8609.2 |

Sources: KP Government ESP, 2008 budget estimate for service delivery

2.52 Geographical Information System (GIS) analysis reveals substantial misallocation of resources over the years. First, GIS analysis of school locations conducted on Swabi district (Annex 5) shows that a large percentage of schools are located relatively close to each other. Almost 77 percent of 546 male primary schools in Swabi have one or more male primary school located within 1km of each other. Another 31 percent has one or more male primary schools located 500m or less from another school. Merging of many closely-located schools and rationalization of teachers would provide at least one classroom and one teacher to each grade without having to spend more resources. Second, the traditional urban-rural categorizations need to be revised. Along the main roads in rural areas, there are large settlements with schools with large enrollments and adequate provision of teachers. These numbers predictably thin out when the distance from main communication arteries decreases. Third, there are pockets of underdevelopment within a relatively developed district that need special policies. In particular, many schools in these pockets have one or two teachers per school. But this should not be interpreted to mean that these schools need more teachers or that electricity, almost uniformly missing in these pockets, needs to be provided at once to these schools. Enrollment in these schools, mostly located at a distance from the urban centers or in mountainous areas, is also low. Community-managed schools with local female teachers, even if slightly lesser qualified, hired by the communities, could be a better solution.

2.53 The KP government remains directly involved in the development planning process. Institutional mechanisms envisaged in the Local Government Ordinance to conduct planning and development at district level were suspended in 2008. District governments, who have already allocated a miniscule development budget, may be made redundant by the new local government law, when they should be better engaged in planning and resource allocations to meet local needs. Without their participation, institutional arrangements are likely to remain in flux in the short term.

2.54 Despite the introduction of output-based budgeting, the spending patterns in KP are erratic and ad hoc. Changing the budget preparation and linking execution to outputs is time consuming and requires institutional change. KP's budgeting process is in transition, and spending priorities do not always reflect planning and are not necessarily clearly linked with outcomes. For example, KP has no mechanisms in place to measure learning progress at school and district level, as Punjab's Examination Commission does, so it is difficult to measure how, if at all, the increased spending is improving learning in the schools.

2.6 Reforms: Issues and Options

2.55 More nuanced, localized policies are needed to better target local issues. The failure of increased spending to improve schooling access for boys and girls is a major cause of concern. The recent gains in secondary education, including those for girls, appear to have been bought at a very high cost. Therefore, the standard education planning policies—hiring more teachers and non-teaching staff, raising salaries, and building more facilities—need to be reexamined. Localized, nimble solutions may be more appropriate, including steps to relieve demand-side constraints and to improve quality with more narrowly-focused policies.

2.56 Focus more on primary education. KP looks unlikely to achieve the MDG of 100 percent primary enrollment by 2015. While more funds are needed for education as a whole, KP is currently spending much more on secondary education than on primary education. Total enrollment numbers at primary schools seem to have plateaued while those in secondary education are still rising. The relative inattention to primary education—remember KP's relative current and development expenditures in this subsector are the lowest of all the provinces, and are falling—needs to be reversed. KP must raise investments at primary level substantially without necessarily diverting resources from secondary level. Focus on secondary level can help growth of private sector by increasing the supply of inexpensive teachers in the local community. Primary education should be the focus of KP's investment in this sector, aimed at improving enrollment rates and learning outcomes.

2.57 The effect of poverty on school participation needs to be addressed. Weak participation of the poorer quintiles in the public schooling system, despite relatively easy access to schools, indicates a need for demand-side interventions to reduce the out-of-pocket and opportunity costs of schooling. The KP government provides free text books and free tuition, but out-of-pocket costs clearly are seen as high for the poorest families.

2.58 Parents need to be mobilized. The fact that parents appear unaware of the generally poor quality of learning should be a warning sign for government. It should launch communication campaigns to inform parents about their role in improving education standards; i.e. to press their schools for better teaching and to become more involved in their children's learning behavior. The ongoing emphasis on parent-teacher committees should be intensified. Without strong parental involvement, resources for quality improvement will be difficult to mobilize.

2.59 The inadequate non-salary allocations need to be increased. Operational spending on both primary and secondary education, already meager, has even fallen further in the last three years. With insufficient running expenditure for teaching, learning materials, and utility bills, the classroom environment is not conducive to effective teaching or learning. Bad school and classroom environments, that fail to engage the attention of students, are considered by experts to be major causes of high school dropout rates.

2.60 Specific issues need to be targeted. The early dropout rate from primary schools (from kachi to form one), especially among girls, should be addressed with the use of both supply- and demand-side measures. Any funding targeting this specific problem shall also be directly pro-poor. The transition from class five to six also needs strong policy attention.

2.61 The National Education Assessment offers data and guidance on how to target resources for improved learning. The use of blackboards, for example, is one solution known to improve learning. So it should be a planning and resource priority to ensure that all schools have functional blackboards and teachers prepared to use them. More non-salary funds would help to achieve this.

2.62 KP should study the example of the Punjab Examination Commission, to help establish a clear linkage of inputs with learning outcomes at teacher, school, and district levels.

2.63 The narrowing gender gap in KP masks the persistently weak enrollment of girls, especially at rural schools. Since distance from schools has been shown to be a relatively insignificant deterrent, policy makers should pursue aggressive demand-side interventions to raise access.

2.64 The low STRs in some remote, poor districts indicate that concerted efforts have been made to improve schooling access. However, simply building schools throughout remote districts, with very low enrollment numbers, may not be the right policy. A more sound policy option might be to remove demand-side barriers, such as providing transport subsidies, hostels and other facilities to encourage participation.

2.65 Multi-grade teaching may be required at some schools with low enrollment. A large proportion of schools have only one or two teachers. Before deploying more teachers and facilities at all schools, enrollments, locations, and feeding schools need to be carefully examined. It may be better to concentrate resources at fewer schools for improved learning, and mix in demand-side solutions, rather than dispersing resources over large number of schools. GIS analysis would be an invaluable aid.

2.66 Private-sector participation is uneven but growing and needs to be encouraged. With only one-quarter of the school-going population in private schools, the private sector has a limited, though growing role in KP's education sector. The KP government may want to consider funding or co-funding new private schools, if entrepreneurs and teachers are available, in areas that are currently not served by public schools. Enabling policies by the Sindh Education Foundation have achieved substantial success in attracting children, especially girls who, for cultural or security reasons, were less likely to walk longer distances to school. The role of KP Education Foundation should be revised, as suggested by the ESP, along the lines of successful Punjab Education Foundation. Emphasis on secondary education in KP may also increase the supply of educated local girls to enable the private sector to set up low-cost private schools.

2.67 Expenditure efficiency requires review and improvements. The greatest challenge in KP—and by extension, Pakistan—is achieving value for money already being spent. This is especially true in light of the fact that teachers' salaries, like other provincial governments, amount to the single biggest recurrent expense of the provincial exchequer. GIS analysis can clearly point out misallocation of resources. While no reliable data on teacher effort and absenteeism rates exist for KP, anecdotal evidence, the government's own documents, data on learning levels, and performance differences between private and public schools, all suggest that KP's education challenges are much the same as in other parts of Pakistan. Therefore, the reform solutions may lie in initiatives such as: (i) community empowerment to fight teacher absenteeism, (ii) contracting teachers locally, (iii) more and better use of technologies such as GIS and information technology, (iv) improving monitoring and management data, (v) strengthening administrative chains of command, and (vi) providing non-salary resources to improve the quality and frequency of field visits. New policies, more technology-based innovations, and substantially more non-salary funds for lower tiers of management and improved supervision could also help.

2.68 Link budgets with sector plans. The sector plans and budgets are often not adequately linked to each other, implying that expenditures remain ad hoc and are not necessarily based on a coherent plan. The ESP places just as much emphasis on reducing primary school enrollment as on raising female secondary education. But the expenditure reality is clearly tilted towards secondary education at the expense of primary education. While many initiatives of

the KP government over the years (e.g. no tuition fee) are laudable, planning documents such as the ESP probably are not consulted when budgets are prepared. This might happen because of pressures from legislators wanting more resources, schools, teachers and non-teaching positions in their jurisdictions. It is undoubtedly difficult to ward off such pressures, and in some cases the demands may be genuine, but structured planning is more important for achieving sustainable and efficient negotiated outcomes.

2.69 Linking school budgets to enrollment will ensure resource flows to need, rather than strength. The problems of over- and under-supply of teachers, and more or fewer resources in any district can best be cured by linking enrollment of the school with the resources to be provided, after taking account of equity and hardship issues.

2.70 New mechanisms for allocating formula-based resources to districts need to be worked out, in the wake of the defunct devolution experiment in KP. A provincial education finance commission award, that provides for planned resources to every district based on current and future needs and government priorities, would facilitate improved planning.

2.71 Improved targeting of under-serviced areas can be achieved through GIS tools. Several schools in KP could be reclassified as 'accessible', as if they were urban, which would enable government to better target resources such as teachers' incentives and other incentives to improve enrollments and outcomes (Annex 5). GIS analysis of one district finds that even within urban or prosperous districts there are population pockets that are not being served with adequate education facilities. Decisions for upgrading of schools from primary to middle, or middle to high, would also improve with on-ground or satellite-based spatial analysis of feeder schools and means of communication. In particular, closely located schools—a wide spread phenomenon—could be merged. Introduction of co-education in first or second grade, already practiced informally, according to KP EMIS, could improve access substantially without adding extra resources. Such planning would be vastly improved with GIS tools and geospatial mapping.

Chapter 3:

The Health Sector

3.1 Introduction

3.1 This chapter reviews public expenditure in the health sector in six sections. After this introduction, Section 3.2 presents recent health reforms, and Section 3.3 assesses progress in sectoral outcomes, and compares provincial health services, service use, access and delivery systems. Section 3.4 reviews public spending and its patterns and efficiency. Section 3.5 presents the budgetary process and Section 3.6 provides recommendations for action.

3.2 Recent Health Reforms

3.2 This review of public health expenditure is timely, coming in the wake of recent reforms that are bound to have a significant impact on the functioning of the health sector in the provinces. The Local Government Ordinance (LGO) of 2001 was abolished in December 2009. The Seventh National Finance Commission (NFC) Award, a five-yearly event, was declared in November 2009, and the 18th Amendment to the Constitution of Pakistan was ratified in April 2010.

3.3 The 18th Amendment will have a profound impact on health sector as its provisions take effect, for it devolves to the

Box 3.1 Key Messages

- At current rate, Millennium Development Goal (MDG) 4 and 5 targets are unlikely to be met within the next decade. Government therefore needs to refocus on basic services for mother and child health, address inequities in this regard and create increased demand for such basic services through health promotion and social mobilization.
- The 18th Amendment has devolved health sector responsibilities to provinces. Financing arrangements for key preventive programs have been ensured by the Federal Government till the end of 7th NFC Award.
- A five pillar health sector strategy guiding health sector management and its spending has been developed by the Province for 2010-17, but the strategy may be overly ambitious in seeking huge external resource support for its implementation.
- Lower-income households in particular spend a significant proportion of their household consumption towards health.
- Public sector health spending as a share of total government spending has more or less remained at around 8 percent for the past five years with a decline in recurrent expenditure share in total health spending.
- Provincial health spending is more towards capital and 'transfer payments' while district health expenditure is more towards remuneration. There is need for a better link between recurrent and capital expenditure to enhance efficiency and effectiveness towards better health outcomes.
- There is a formula for health allocation at district level, however, the formula does not address needs, and therefore the districts have variable per capita health spending.

provinces important health sector responsibilities which were previously handled by the federal government. It came into effect at about the same time as a 'recentralization' of health responsibilities to provinces from the districts. The Amendment, however, has not explicitly spelled out what the citizens can expect from the provincial level. Under the Amendment, the federal government retains control of regulations, while legislation, service delivery and financing are provincial subjects. The federal government has agreed only to finance preventive programs as an interim arrangement till end of 7th NFC award. The federal government handles human resource regulation, and as the provincial governments take over the responsibility for policy formulation and legislation they will face serious challenges, given their capacity constraints. There will also be issues relating to governance, equity, efficiency and effectiveness. The timing of the full devolution and its implementation are still unclear, although the measures came into effect on July 1, 2011.

3.4 The Seventh NFC Award focused on revenue collection and increasing allocation of resources to provinces. The award, in November 2009, increased the provincial share of revenues to 56 percent, from the 48.75 percent that had been allocated in 1997 under the Fifth NFC Award. The seventh award introduced a new formula for provincial allocations and added socio-economic criteria for consideration in addition to population size. Population now comprises 82 percent of the formula, with poverty (10.3 percent), revenue (5 percent), and numbers of internally displaced people (2.7 percent). Least-developed provinces, such as KP and Balochistan, benefited most from the formula because of the new criteria. As a result, KP received a higher allocation weighting of around 14.62 percent in 2011—a 25 percent nominal increase over the 2007 allocation.

3.5 The abolition of the LGO of 2001 meant that the devolved health responsibilities of the districts would no longer be in effect. Each province will have to develop its own local government ordinances to reestablish its roles and functions for various levels of administration in health and other sectors. The Khyber Pakhtunkhwa Local Government Act 2012 has recently been passed by the legislature—its implications on health still need to be studied.

3.6 The various National Health Policies (of 1997 and 2001) stress the importance of good governance, health care quality, equity of access and reducing the burden of disease. These policies preceded the 18th Amendment and did not anticipate devolution of health to the provincial level. Financing of vertical programs, such as LHW and immunization program, will be ensured by the federal government until the next NFC Award, with interim management by the Ministry of Inter-Provincial Coordination. The provincial strategies now need to take up the policy areas identified and adopt them to provincial needs.

3.7 KP's Department of Health developed a Health Sector Strategy (2010-17) in 2010, in anticipation of the 18th Amendment. The KP strategy states one of its goals is to improve the health status of the population in the province through ensuring access to a high quality, responsive healthcare delivery system which provides acceptable and affordable services in an equitable manner'. The strategy identifies five key objectives: (i) enhancing coverage and access to essential health services, especially for the poor and vulnerable; (ii) achieving a measurable reduction in morbidity due to common diseases, especially among vulnerable segments of the population; (iii) improving human resource management; (iv) improving governance and accountability; and (v) improving regulation and quality assurance. According to the KP Comprehensive Development Strategy (2010-17), a priority during the first phase will be to improve management of, and medical knowledge among staff. The second phase will consider the population's challenges to improve equity and access to health services. The strategy proposes a minimum health service package (MHSP) costing about Rs 340 per capita for district health services, which comprises 17 percent of the total provincial public health financing (including primary, secondary and tertiary health services) for 2009. The strategy suggests that sufficient government funds may be available to cover non-salary recurrent costs, although there may be a funding gap of 57 percent for covering development costs (2011-17) which is expected to be covered through external financing. The situation, however, has to be re-assessed in light of the 18th Amendment and Seventh NFC Award.

3.8 This Public Expenditure Review for the health sector in KP province examines the situation of public sector health spending and its effectiveness over the period 2006-11. The data used for these analyses include public

expenditure data from the Accountant General, and household surveys such as the Pakistan Living Standard Measurement Survey (PLSMS 2011), KP Multi-Cluster Survey (K-MICS2001 and 2008) and Pakistan Demographic and Health Survey (PDHS 2007). Other reports prepared by the government and/or other development partners were also consulted as references.

3.3 Health Status and Service Utilization

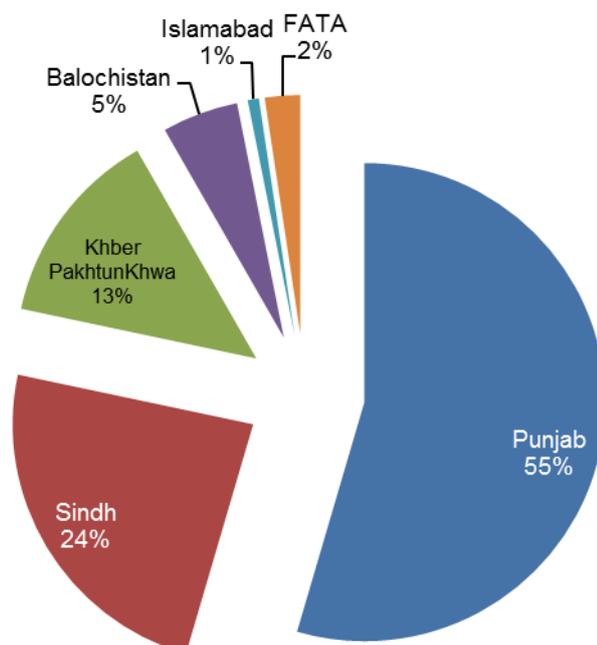
Socio-Economic Profile of Khyber Pakhtunkhwa

3.9 KP has a population of 23.77 million, which is about 13 percent of the national figure (2011 est., Figure 3.1), and one-quarter of its people are below age 15. The fertility rate is 5.16 (2008). The province has four administrative sub-regions—Hazara, Malakand, Central and Southern—that together contain 23 districts.

3.10 The proportion of population living below the poverty line has declined significantly to 17 percent in 2008 from 41 percent, 10 years earlier. This is thought to be mainly due to the inflow of remittances. Agriculture is the largest employing sector. The political and social crisis in the province has driven unemployment above the national average, and a large part of the population is displaced (IDPs are estimated to be around 2.3 million).

3.11 Low literacy. Overall adult illiteracy is about 62 percent, higher than the national average. The literacy rate among 15 to 24 year-olds is 63 percent (2008), but with a wide gender gap: 81 percent of men are literate while this number is only 45 percent for women.²³

Figure 3.1 Population Distribution by Provinces (2011 est.)



Source: World Bank staff estimation using Pakistan census data.

²³ K-MICS, 2008.

3.12 An epidemiological transition is underway, although communicable diseases are still highly prevalent and remain the leading cause of morbidity and mortality. There is also a growing incidence of non-communicable diseases, mental health issues and physical injury.²⁴ Child health developments are mixed at best in KP: the IMR is 63 compared to the national average of 78²⁵, although it was reported to have reached 76 in 2008²⁶, which may indicate a rise. Women’s health problems are acute throughout the country, but KP has percentage rates lower than the national average for women giving birth at health facilities, receiving both antenatal and postnatal care from a skilled provider. Women who did not use the services said they refrained from doing so primarily because of lack of knowledge and the cost of care. Health service use is low nationally, but KP’s numbers are worse than the national average for essential services such as treatment of children with symptoms of pneumonia or for the treatment of diarrhea with the provision of fluids (Table 3.1). The main programmatic challenge as compared to other provinces is fertility and contraceptive use—this is one area where KP lags other provinces and is below national average having future implications. In addition, KP suffers from high rates of malnutrition which have not changed during the last two decades as in the rest of Pakistan.

National and International Comparison of KP Health Outcomes

3.13 Pakistan has shown significant progress in life expectancy at birth. Pakistanis are living longer, with life expectancy at birth having risen to 63 years for men and 64 years for women—above the average for countries with similar income and health spending.

3.14 Maternal and child health outcomes are lower than other countries with similar income and health spending. The causes of infant and child mortality are mostly communicable, and could be easily prevented through cost effective interventions. The percentage of women delivering babies in the care of a skilled birth attendant or health facility is low.

3.15 Pakistan is unlikely to meet the health MDG. Infant, child and maternal mortality rates have improved, but only slowly. In 1990, the mortality for under-five-year-olds in Pakistan was high, but Nepal, Bangladesh and Bhutan were worse off. By 2009, Pakistan’s under-five mortality rate had fallen behind its neighbors’, and far above the MDG targets. The maternal mortality rate has also declined slowly, due in part to low percentage of women giving birth under professional care. India, Indonesia and Bhutan outperformed Pakistan in this aspect of health care in the period 1990 to 2009. A rough estimate suggests that at current rate, it may take ten more years to achieve these goals.

²⁴ A burden of disease study is not available for KP which may otherwise help better understand the changing epidemiological profile. The draft Health Policy of 2009 states that at least one-quarter of Pakistani adults are obese and have cardiovascular concerns. Injuries and accidents make up about 11 percent of the country’s total burden of disease.

²⁵ The PDHS (2007) has stated that the mortality information for KP is not reliable. However, the authors have used this information to illustrate the differential between KP and the national average. The authors have generally used the MICS (2008) figures, although that analysis was done only for KP and cannot be reliably compared to the national levels for 2008.

²⁶ K-MICS 2008

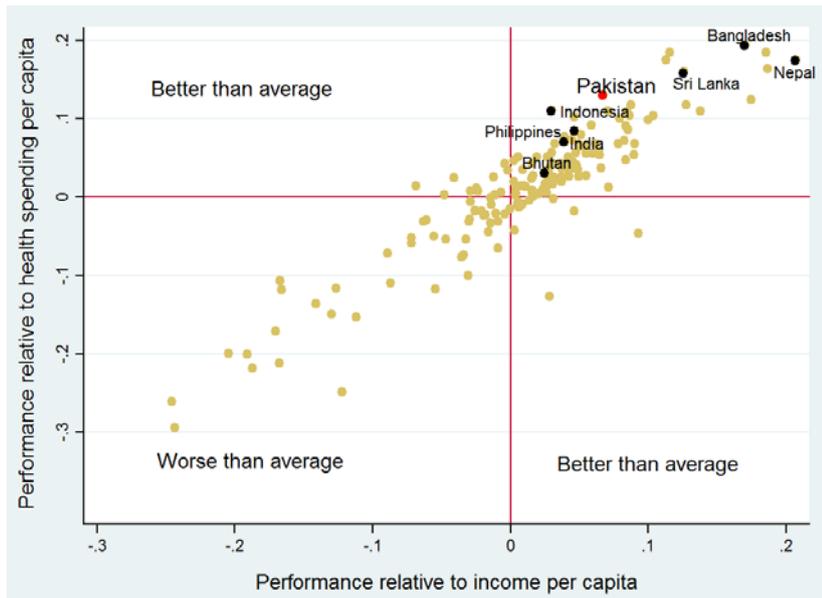
Table 3.1 Basic Health Indicators for KP and Pakistan (2008 or Latest Year)

| Health Indicators | KP | | Pakistan | |
|--|--------------|-------------|--------------|--------------------|
| | K-MICS, 2008 | DHS 2006/07 | DHS, 2006/07 | MDG Targets (2015) |
| Maternal mortality ratio (per 100,000 live births) | | 275 | 276 | 140 |
| Under-five mortality rate (per 1000 live births) | 100 | 75 | 94 | 52 |
| Infant mortality rate (per 1000 live births) | 76 | 63 | 78 | 40 |
| Neonatal mortality rate (per 1000 live births) | 41 | 41 | 54 | |
| Total fertility rate | 5.16 | 4.3 | 4.1 | 2.1 |
| Contraceptive prevalence rate (any method) | 39% | 25% | 30% | 55% |
| Percentage of women delivering at health facilities (institutional delivery) | 39% | 30% | 34% | |
| Percentage of births attended by skilled birth attendants | 41% | 38% | 39% | 90 |
| Percentage of pregnant women receiving antenatal care from a skilled provider | 47% | 51% | 61% | 100 |
| Percentage of women delivering receiving post natal care from a skilled provider | 12% | 27% | 43% | |
| Percentage of women delivering receiving post natal care from a skilled provider within 2 days of delivery | | 23% | 39% | |
| Fully immunized children (12-23 months) | 76% | 47% | 47% | |
| Incidence of children (0-59 months) with diarrhea in the last 2- weeks | 43% | 25% | 22% | |
| Fluids given to children during diarrhea (received ORT or increased fluids, and continued feeding) - (0-59 months) | 44% | 54% | 55% | |
| Incidence of suspected pneumonia among children (0-59 months) | 20% | 170% | 14% | |
| Use of provider when child has suspected pneumonia / Acute respiratory infection (0-59 months) | 57% | 50% | 69% | |

Source: K-MICS 2008; PDHS 2006-07; UNDP 2011

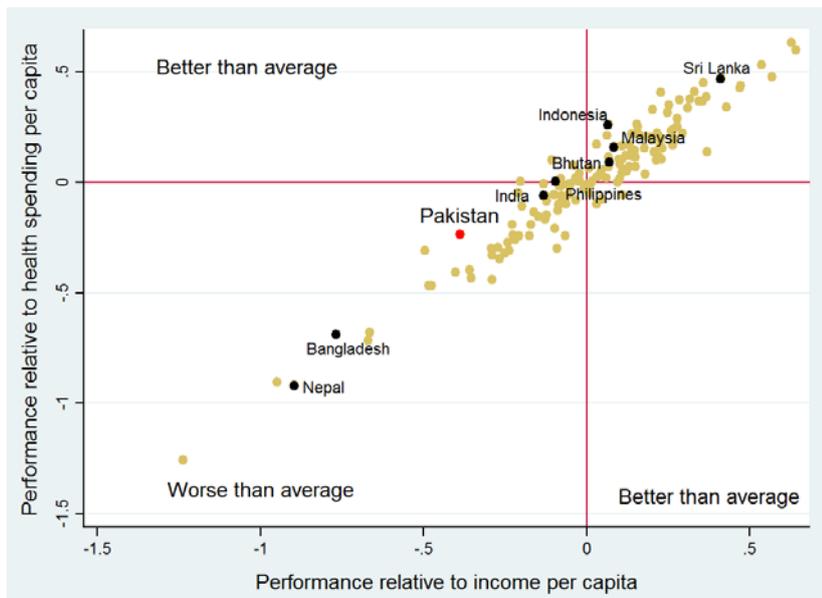
Note: PDHS mortality estimates for KP are not reliable.

Figure 3.2 Life Expectancy at Birth in Pakistan Compared to Other Similar Countries



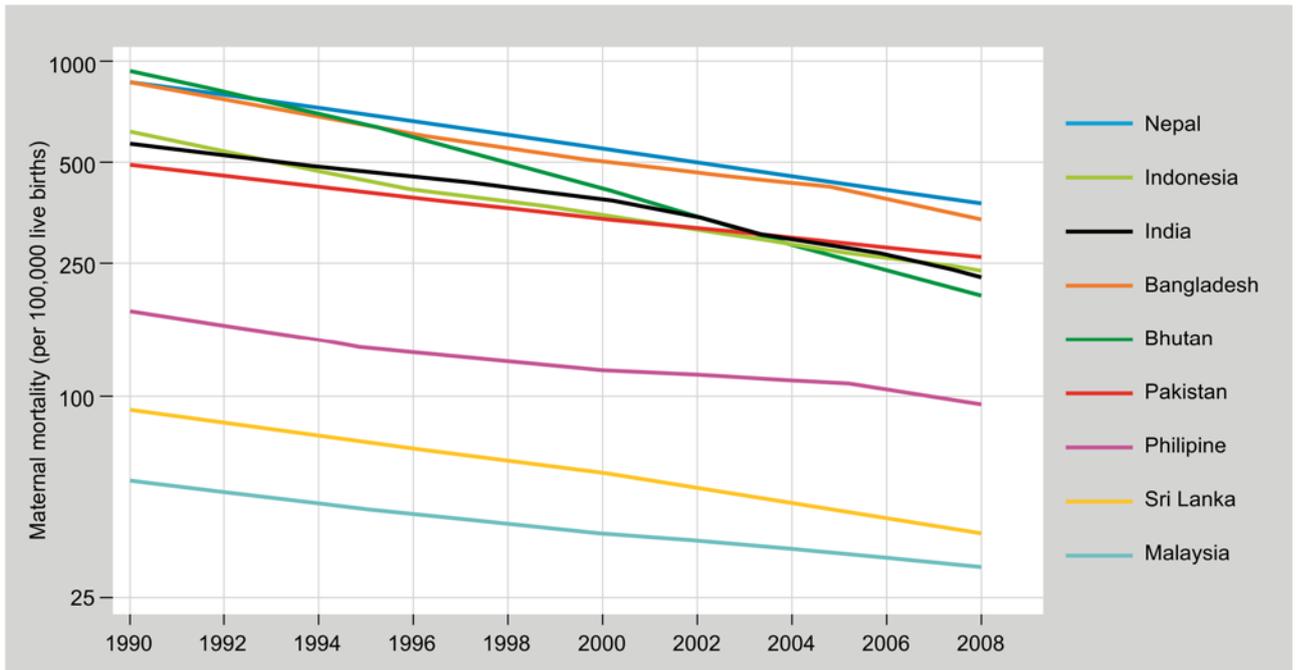
Source: World Development Indicators (2010), WHO (2010) and Royal Monetary Authority (2009)
 Note: Both axes are in log scale

Figure 3.3 Maternal Health Outcomes in Pakistan—An International Comparison



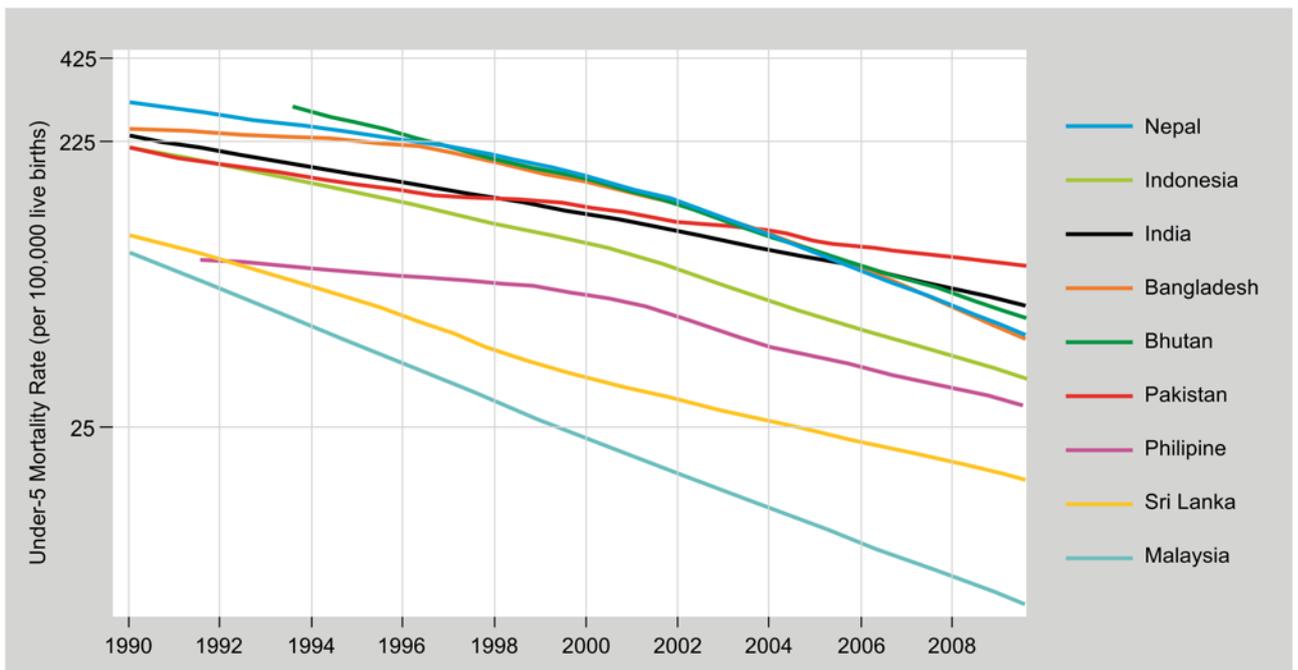
Source: World Development Indicators (2010), WHO (2010) and Royal Monetary Authority (2009)
 Note: Both axes are in log scale

figure 3.4 Maternal Mortality (per 100,000 Live Births)



Source: World Development Indicators (2010), WHO (2010) and Royal Monetary Authority (2009)
 Note: Both axes are in log scale; latest available data is for 2003-09

Figure 3.5 Child Health Outcomes in Pakistan Compared to Its Neighbors (1990-2009)



Source: World Development Indicators (2010)
 Note: y-axis log scale

Comparison of Health Service Utilization in the Provinces

3.16 There is considerable variance in health service use among women and children of different provinces. Sindh and Punjab have the highest use of antenatal services in health facilities and highest rates for institutional births, while KP and Balochistan have the lowest. Immunization coverage of children is low throughout Pakistan. KP's rate is actually somewhat higher than the other provinces. However, health service use by children with acute respiratory infection is comparatively low in KP and Balochistan. Overall, KP's health service use by mothers and children is among the lowest in the country.

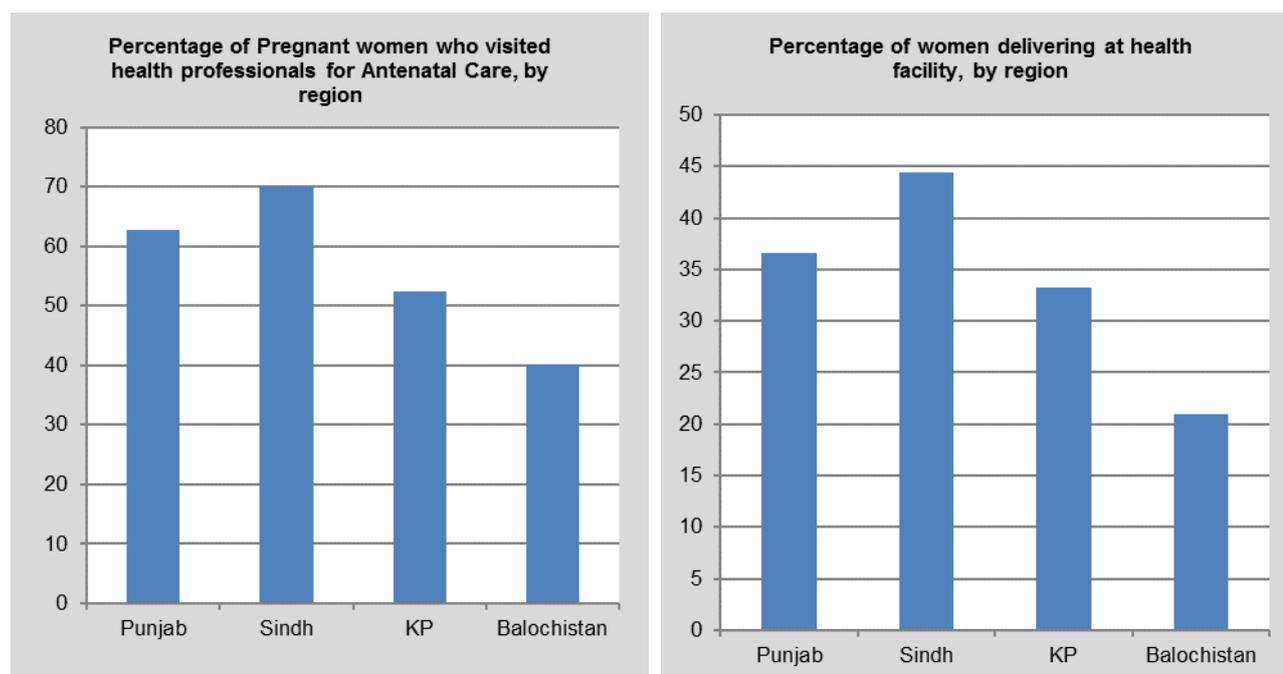


Figure 3.6 Health Services Used by Pregnant Women, by Province (%), 2007)

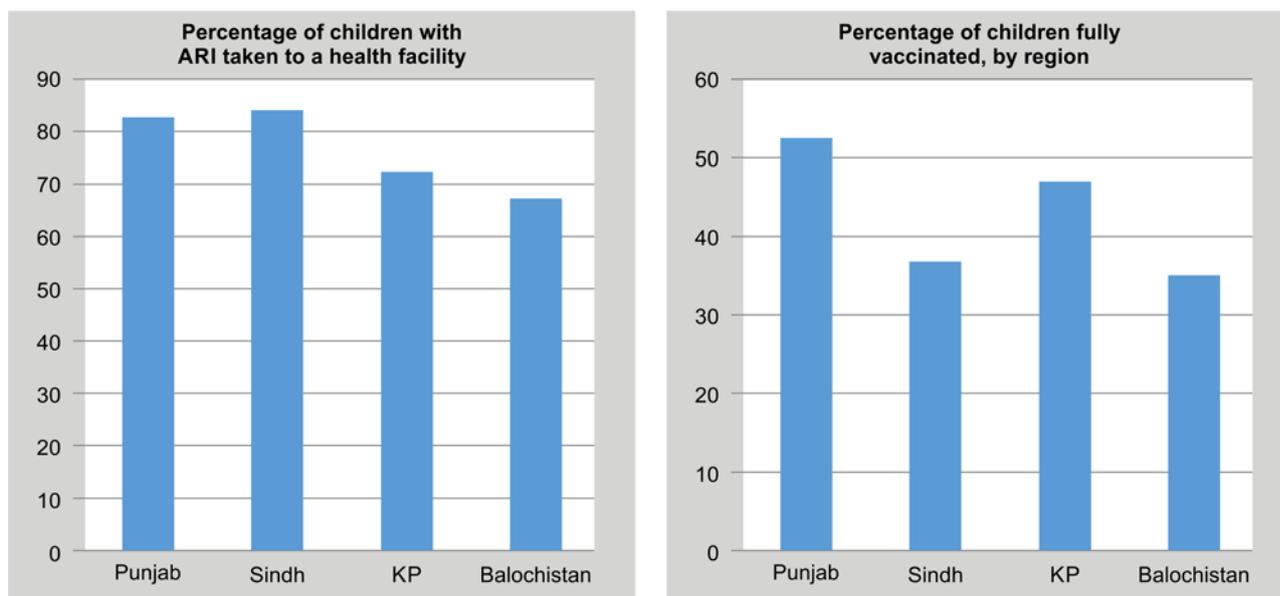
Source: PDHS 2007

Child Health and Service Use

3.17 Child health in KP has deteriorated. While the infant mortality rate (IMR) for Pakistan as a whole seems to be slowly improving, the IMR in KP may have worsened, or at best stagnated, between 2002 and 2008 (at around 76 deaths per 1,000 live births)—a worrisome phenomenon. The rural IMR is significantly higher (78) than the urban (62). Infant mortality for girls is also notably higher (79) than that of boys (73). Neither Pakistan nor KP is likely to meet the MDG-4 target.²⁷

3.18 Indicators for child health have declined overall in KP in recent years. The incidences of stunting and wasting have worsened, and full immunization coverage of children—critical to preventing communicable diseases—has declined.

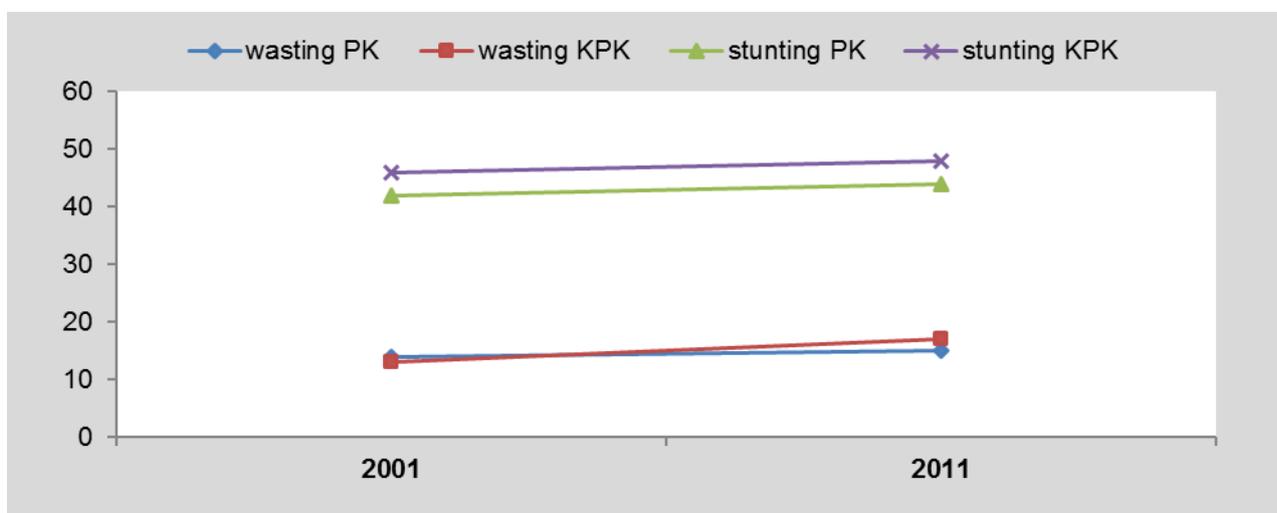
²⁷ UNDP 2011

Figure 3.7 Health Services Used for Children, by Province (% , 2007)

Source: PDHS 2007

Note: ARI is Acute Respiratory Infection.

3.19 Poor feeding of infants is prevalent in KP, which often leads to under- or mal-nourishment (Figure 3.8). For babies to have good nutrition, it is important for pregnant women to also have adequate nutritious intake and to adopt appropriate feeding practices for their infants. The WHO and UNICEF recommend that infants under six months of age be breastfed exclusively. They also recommend continued breast feeding up to 24 months of age. In KP, however, only 45 percent of infants six months and younger are exclusively breastfed for the first six months.²⁸ The finding calls for more intensive healthcare communication to improve the knowledge and nursing practices of mothers.

Figure 3.8 Malnutrition Status Among Children Under Five Years (2001, 2011)

Source: Pakistan National Nutrition Survey 2011

²⁸ K-MICS, 2008.

3.20 Declining immunization coverage among children in KP is a concern, and is a consequence of weak health systems and limited knowledge about the benefits of vaccination. The declining immunization coverage in KP between 2002 and 2006 points to both supply and demand deficiencies. The Department of Health (DOH) administers vaccination service through its clinics, mobile outlets, and outreach workers (vaccinators). A shortage of health care workers for routine EPI services is common because they are also engaged in services such as disease eradication or elimination campaigns, which run simultaneously and offer special incentives. The eradication of polio, elimination of measles and neonatal tetanus programs all have multiple campaigns. Pakistan is one of the few countries still plagued by polio, and KPK and Balochistan face stern challenges in reaching all children in the target group. Cold and supply chains are also challenged, especially in remote and mountainous regions, and are further complicated by severe electricity shortages. Operational budgets are limited, monitoring and supervision is weak, and workers do not have incentives to achieve or raise target levels. In KP, many vaccinator posts are unfilled, and fixed health centers do not offer regular vaccinations. On the demand side, many mothers know little about the need for child vaccination or its schedule so they fail to have their children immunized, or do so not according to the schedule.²⁹ Although child vaccinations are provided free of charge at public clinics, travel may be arduous and cost prohibitive. Cultural norms may inhibit women from traveling on their own to clinics; they might require accompaniment by their spouse or a relative, which might be difficult to arrange for times that match clinic working hours.

3.21 The proper use of health care is low for three main reasons: people know little about health care needs, distance to clinics may be far, and direct and indirect costs are high. The practice of going to health services or taking appropriate medicines or supplements, when sick, seems to be uncommon in KP. A survey found that some 43 percent of children (0-59 months) had had an episode of diarrhea within two weeks of the survey, but only 44 percent of those were given appropriate rehydration salts and/or fluids.³⁰ Rehydration salts are available at health clinics, medical stores, pharmacies and even some grocery stores. Rehydration fluids can be prepared at home as well. However, the survey findings indicate that knowledge is poor among mothers, and that there is also a need to improve access to oral rehydration solution in some cases. A similar pattern was found among children with suspected pneumonia: while 20 percent of children (0-59 months) in KP were reported to have suspected pneumonia, only 57 percent of them were actually taken to a health care provider for care. The mothers' knowledge of the risks from pneumonia was low: only 1 percent of mothers were able to recognize (at least two of) the risk signs.³¹ Low use of basic services may also be caused by the long distance between the home and the facilities in some rural parts of KP. Related travel costs may further reduce access to health services.

3.22 Sub-regional and district variations are evident in child health service use. While the overall health service use is low, the Malakand sub-region is the worst in KP for child health care use. Malakand covers the districts in the Northern and Northwestern regions of the province, and also has the worst access to sanitation and clean water.

3.23 Income differentials are evident in child health service use. Children in the lower income quintiles have lower immunization coverage and health service use for various illnesses than the higher quintiles. This is of special concern as they live in more adverse health environments. The poor therefore have worse health outcomes.

²⁹ The EPI Coverage Evaluation Survey 2006.

³⁰ K-MICS 2008

³¹ K-MICS 2008

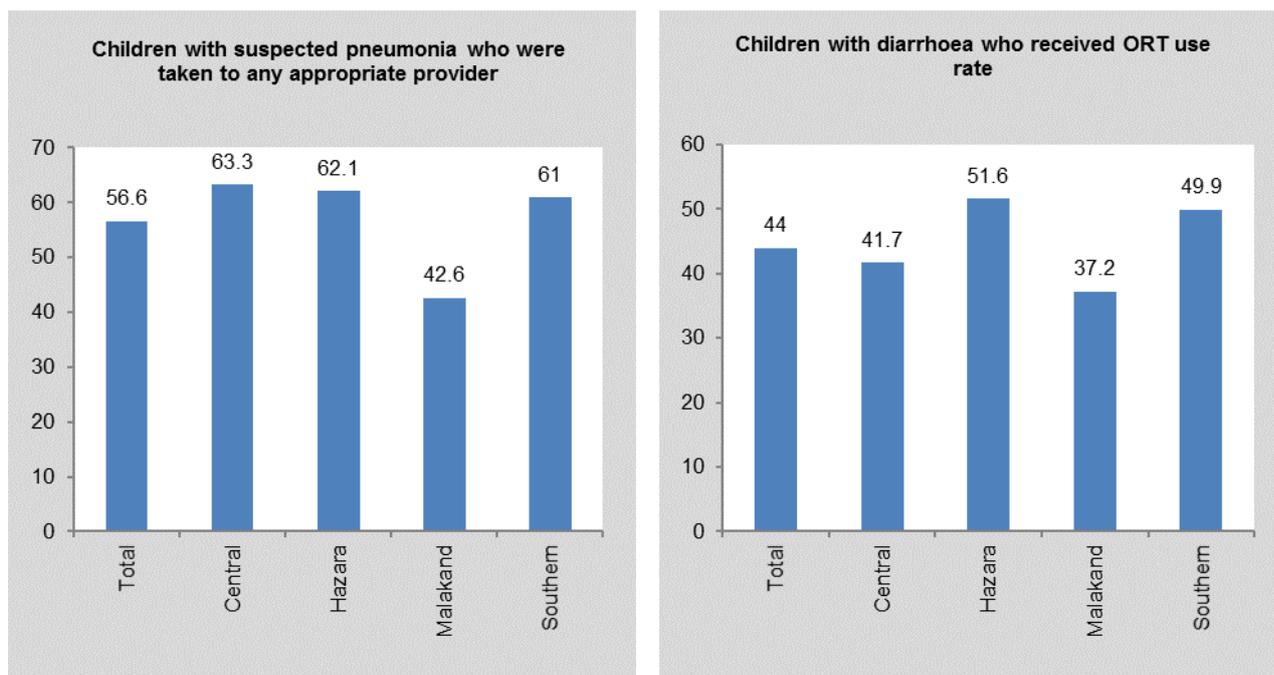


Figure 3.9 Use of Appropriate Providers and Services by Sub region (2008)

Source: K-MICS 2008

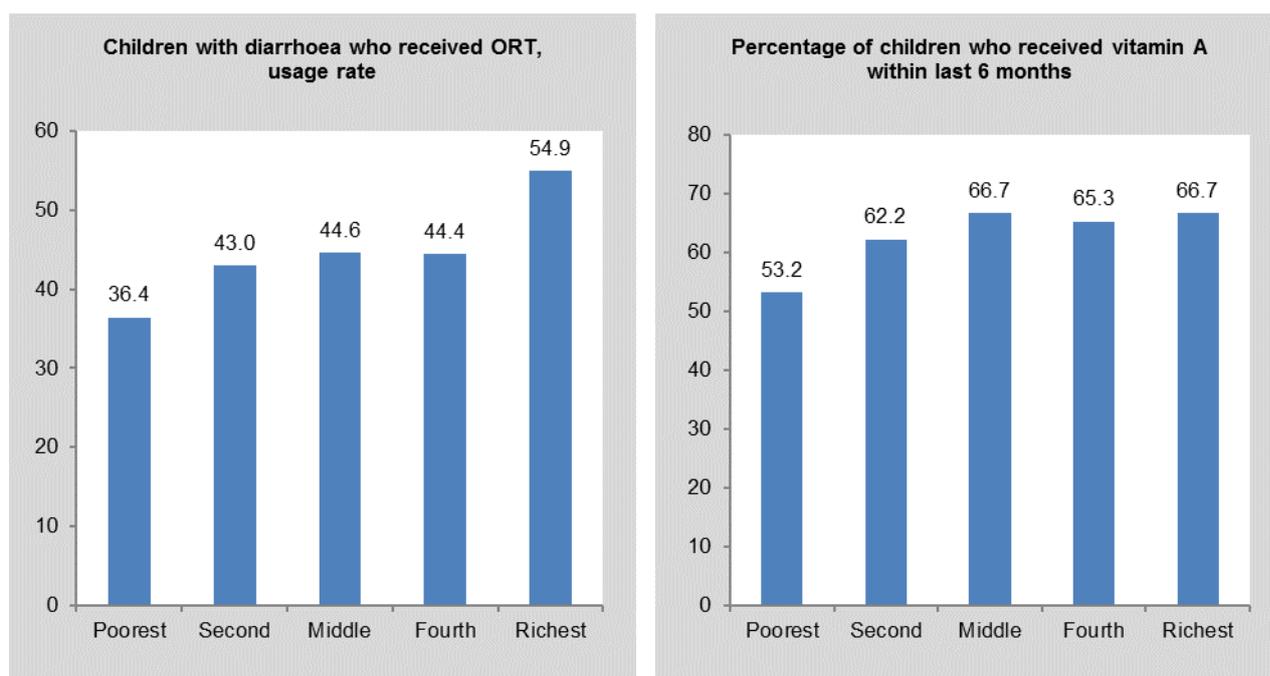


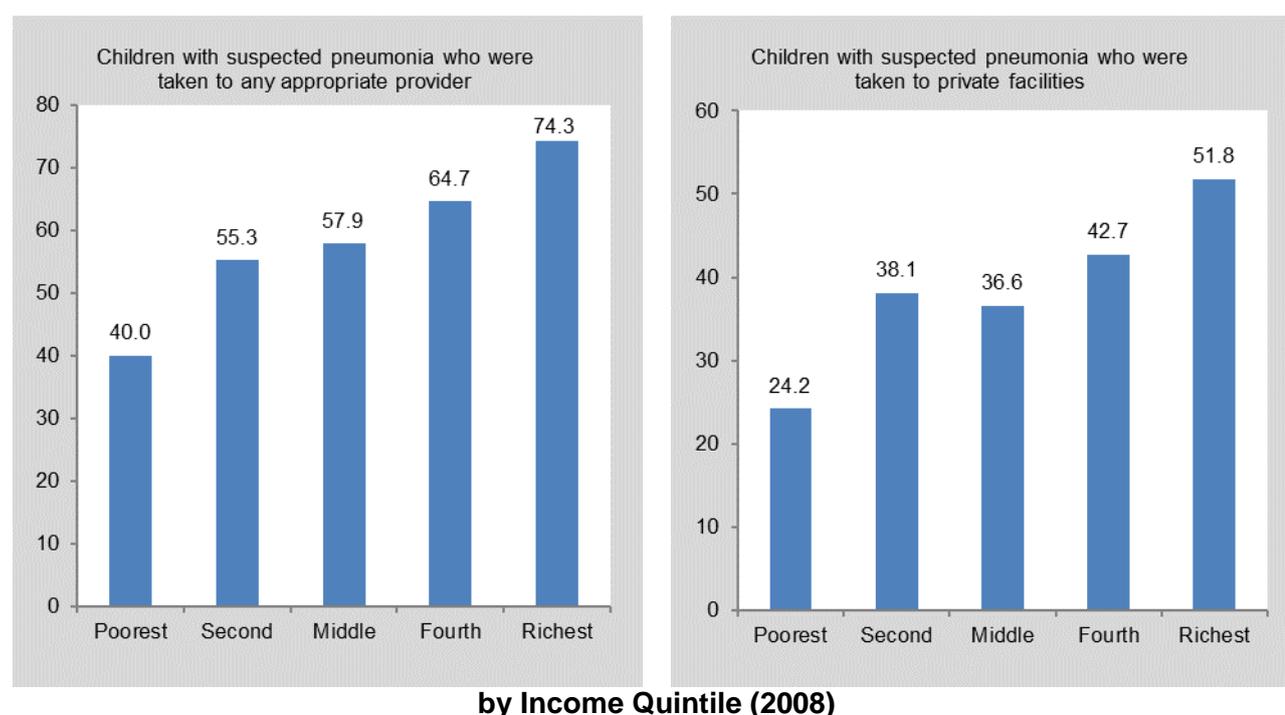
Figure 3.10 Use of Appropriate Services by Income Quintile (2008)

Source: K-MICS 2008

Note: ORT is oral rehydration therapy

3.24 A large proportion of children go to private health care providers, especially in higher income quintiles. Generally, households choose a particular care provider because of (i) relative proximity, (b) price of care, and (c) perceived higher quality of care. The public sector provides free services and medicines depending on availability. It also provides free medicines for the public health vertical programs, such as TB-DOTS,³² Malaria, the Expanded Program on Immunization (EPI) and others. The private sector charges user fees and drug prices are twice or three times as high as international reference prices.³³ A study also suggests that private health practitioners in KP charge on average more than their counterparts in other provinces, by as much as three times the national average.³⁴

Figure 3.11 Pneumonia among Children under Five Years & Use of Health Facilities



Source: K-MICS 2008

Women's Health and Use of Services

3.25 Women's health status has improved over time but increments are low. This situation prevails all over Pakistan. Maternal mortality ratio in KP was reported to be about 276 deaths per 100,000 live births in 2007, far below the MDG targets. Pakistan and KP look unlikely to meet the targets for MDG-5.³⁵

3.26 Women's health status remains dismal. While there has been an overall improvement in the use of antenatal care and rate of deliveries under care of skilled birth attendant (SBA), wide disparities in health service use remain between districts. Institutional delivery is far lower in some sub-regions, such as Malakand and Southern.

3.27 Of the women who have gone to skilled birth attendants, most prefer public facilities. Women in the lower-income quintiles prefer to deliver at home and of those who use skilled birth attendants, most prefer to be attended

³² Tuberculosis—Directly Observed Treatment Short course.

³³ WHO 2010.

³⁴ UNDP 2010; PKR 728, 2010.

³⁵ UNDP 2011

by a doctor. Normal delivery can easily be handled by a skilled midwife or a nurse (Figure 3.12, 3.13 and 3.14). However, women seem to have more faith in doctors and public health facilities. This finding is not mirrored in the rest of the country, where women prefer to go to private health facilities for delivery. In KP, women either perceive the quality of public facilities to be better, or they have easier access to public facilities at the time of delivery.

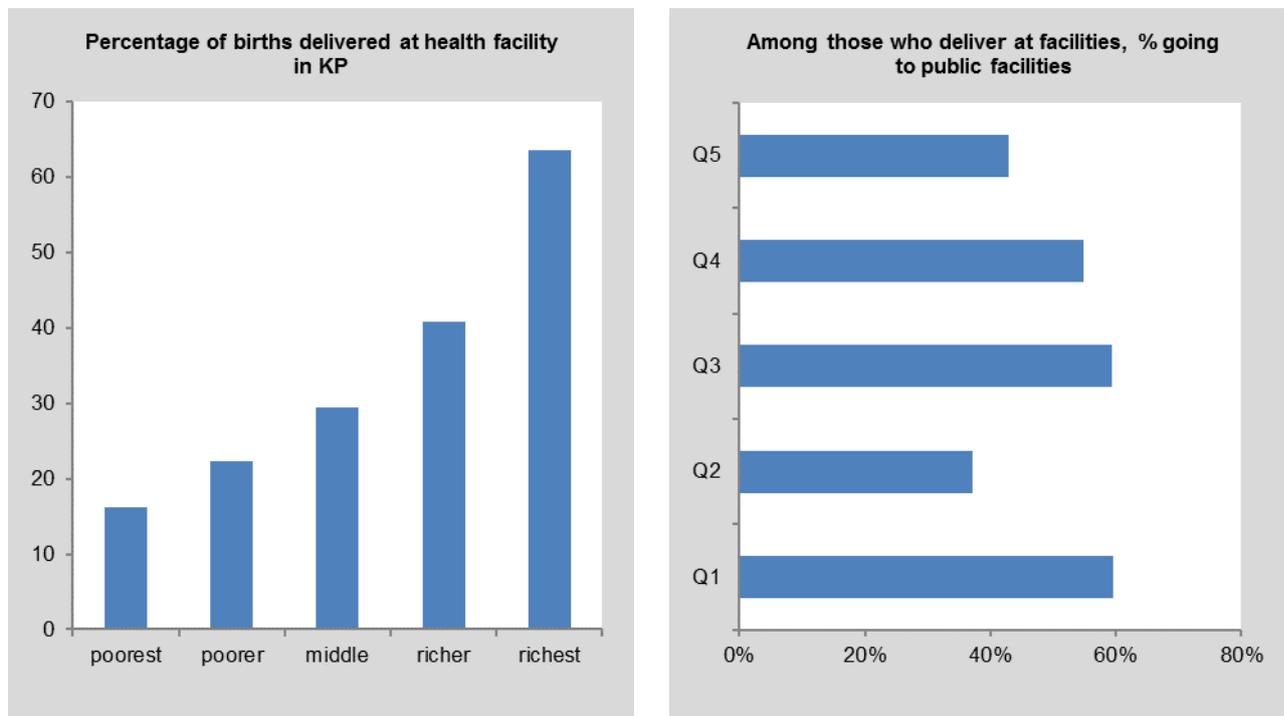


Figure 3.12 Place of Delivery for Institutional Births by Income Quintile (2007)

Source: PDHS 2007

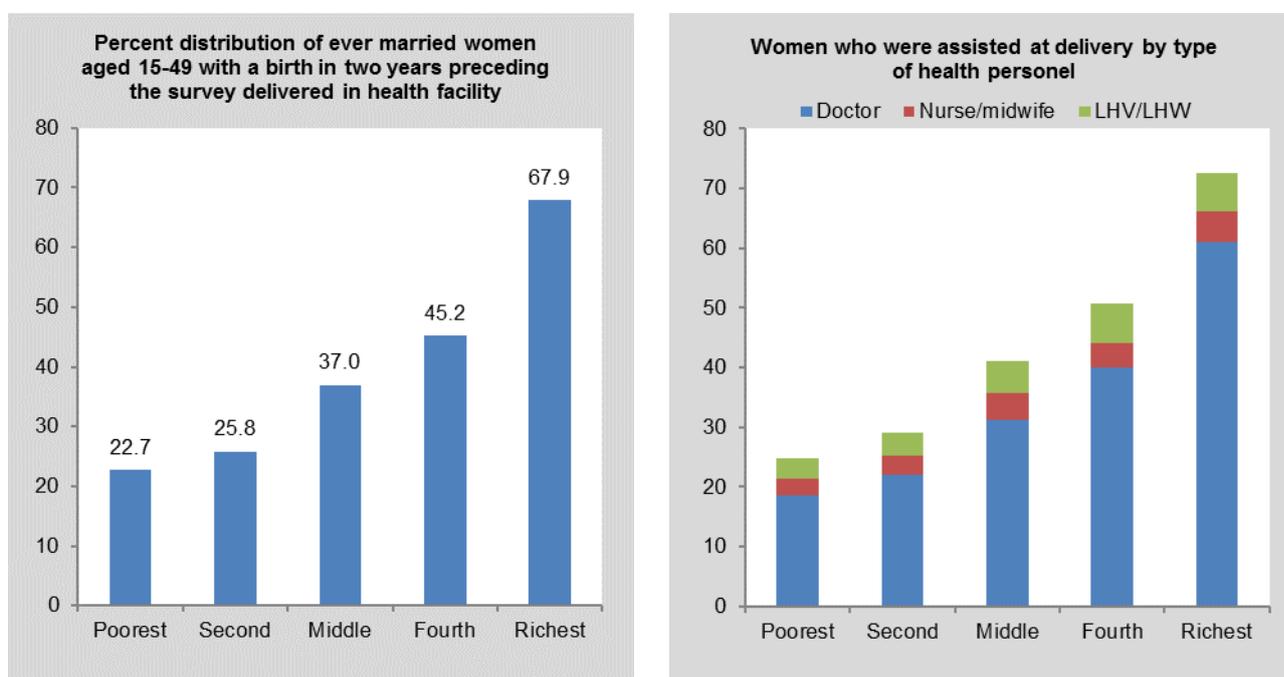


Figure 3.13 Institutional Delivery and Place of Delivery by Income Quintile (2008)

Source: K-MICS 2008

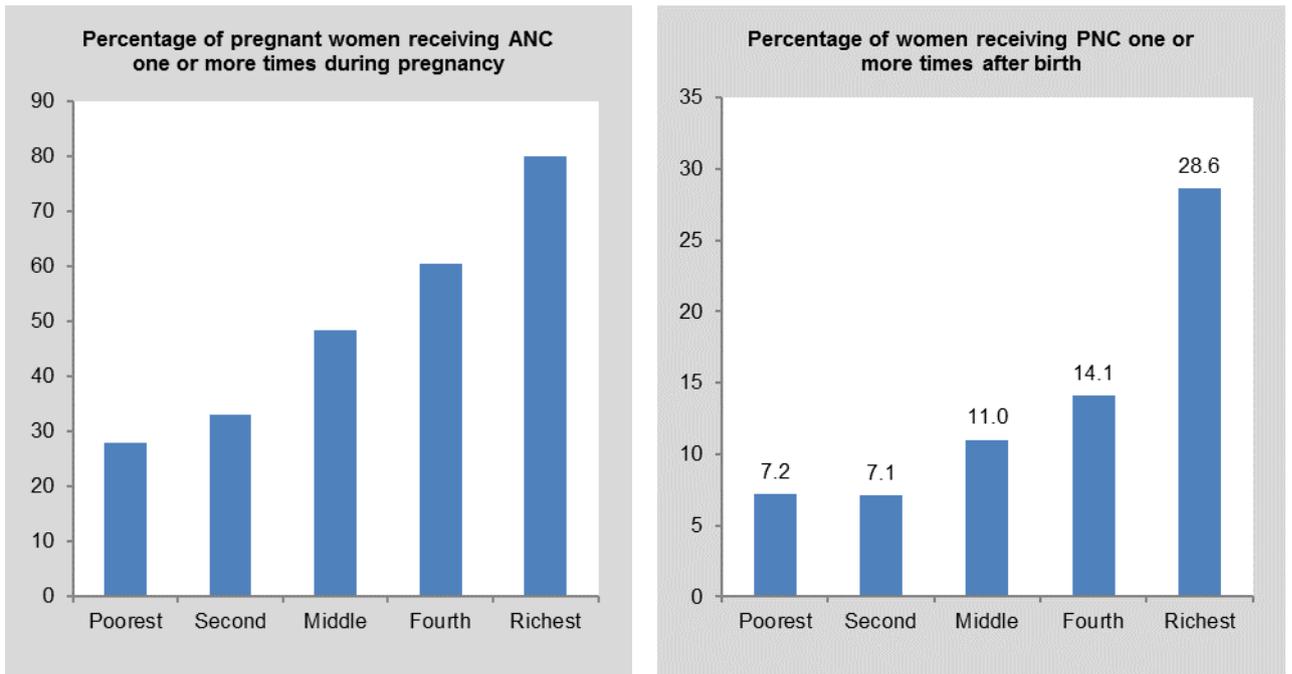


Figure 3.14 Women Using Maternal Health Services by Income Quintile (2008)

Source: K-MICS 2008

Note: ANC: Antenatal Care; PNC: Postnatal Care

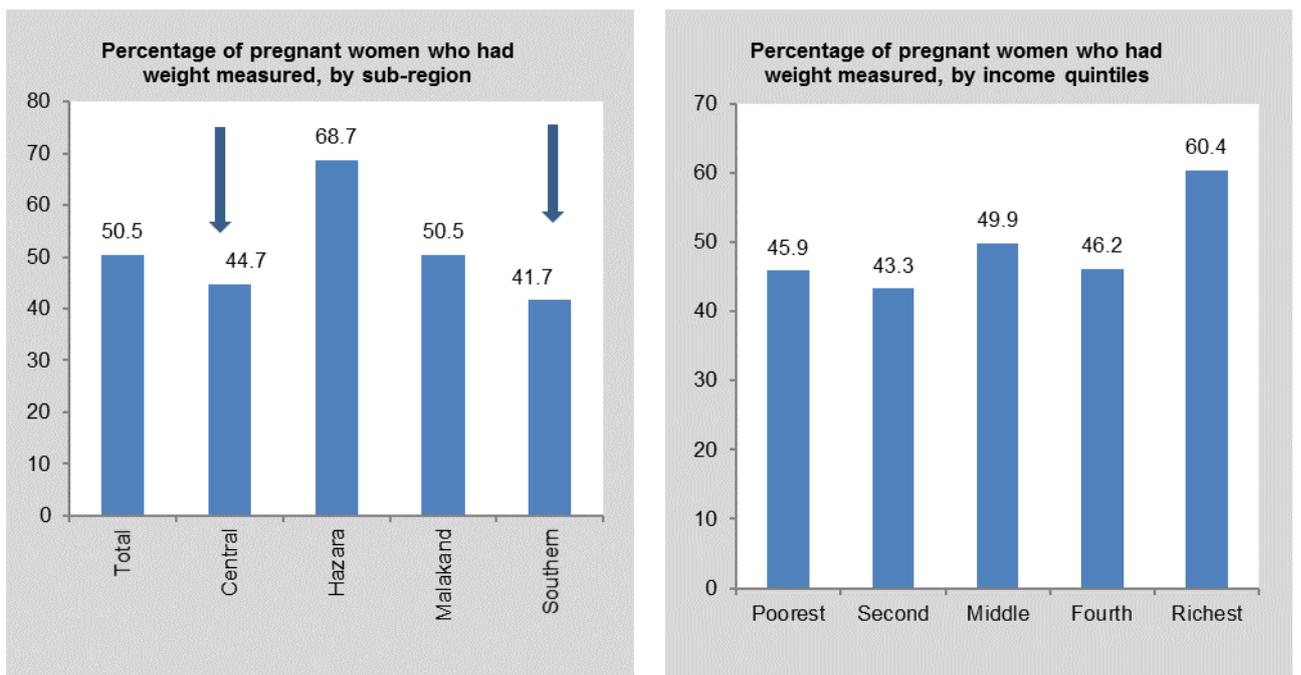


Figure 3.15 Quality of Care Received by Women, 2008

Source: K-MICS 2008

3.28 Sub-regional and income differentials are also noted in the use of contraceptives and unmet needs for contraceptives remain high (Figure 3.16 and 3.17). The Malakand and the Southern sub-regions have the highest unmet need for contraceptives and the lowest family planning use. Income differentials are also noted, with the lowest income quintile having the highest unmet need for contraceptives. This finding suggests a need to review the family planning program and its access by the population. The high unmet needs for contraceptives in some sub-regions, particularly those with the lowest income quintiles, suggest both demand and supply factors at play.

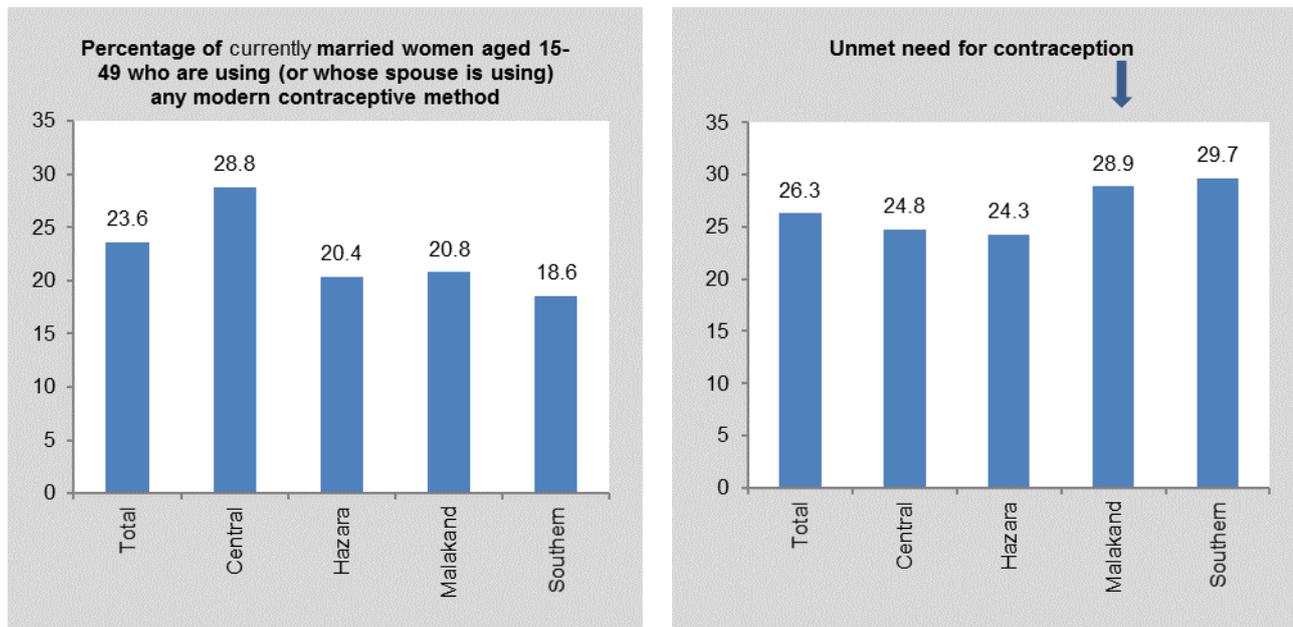


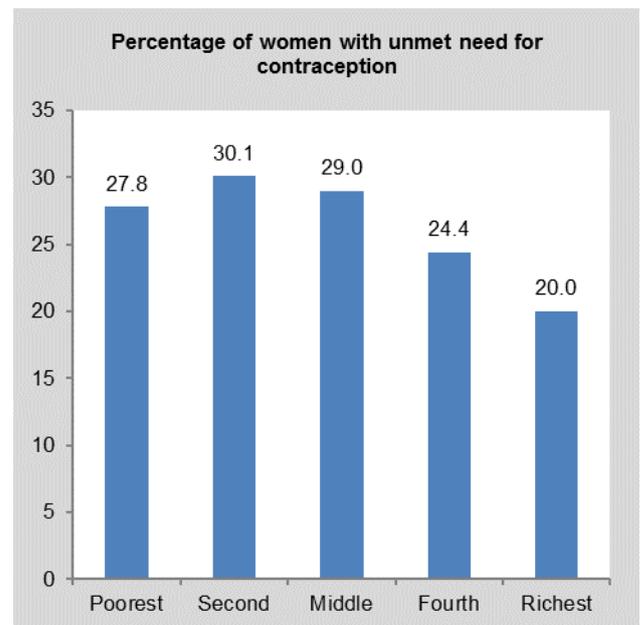
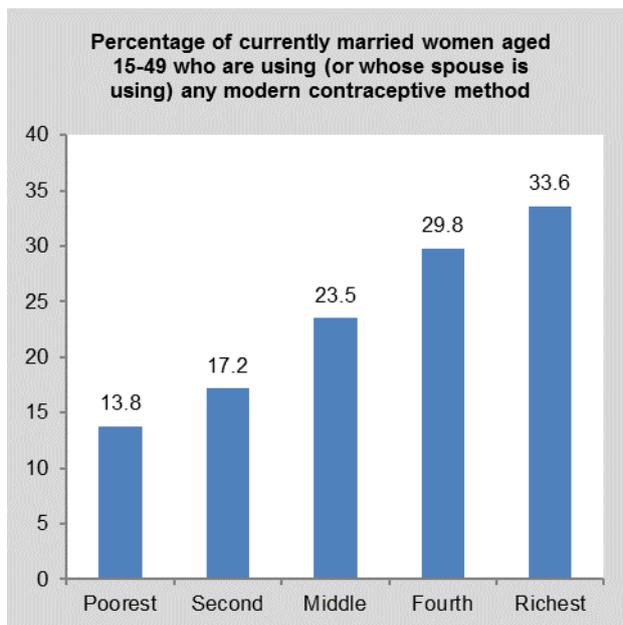
Figure 3.16 Use of Contraceptives and Percentage of Women with an Unmet Need³⁶ by Sub-regions (2008)

Source: K-MICS 2008

Figure 3.17 Use of Contraceptives and % of Women with an Unmet Need for Contraceptives by Income Quintile (2008)

³⁶ Unmet need for contraceptives refers to a lack of access or availability of contraceptives to women who need these products for family planning purposes.

Source: K-MICS 2008



Overall Patterns of Health Service Use and Quality of Care

3.29 Unlike the rest of Pakistan, KP's population seems to prefer public to private health facilities (58 percent).³⁷ The preference is nearly the exact reverse of the rest of Pakistan, where 60 percent of the population chose private facilities in 2010.

3.30 A smaller proportion of KP's population uses public sector primary health care centers (24 percent) than public hospitals (31 percent). Among public facilities, the KP population goes to district headquarter hospital (21 percent) and rural health centers (14 percent). Basic health units (BHUs) are not widely used, with an average of about 7 percent of health service users in KP choosing a BHU, compared to the Pakistani average of 12 percent, and 14 percent to 15 percent in Punjab and Balochistan.

3.31 The quality of care at public-sector health facilities in KP is below the national average. Health facilities in KP are often deficient in terms of services and infrastructure: only one in three has a comprehensive program raising awareness among patients, 40 percent has a patient complaint registration program, and just two-thirds has water and electricity. KP facilities score below the national average for having a waiting room for women or a separate female washroom in the outpatient clinic, a separate consulting room for outpatient consultations and for offering privacy during clinical examination.³⁸

3.32 The proportion of the population 'dissatisfied' with government health services has increased since 2002. Fifty percent of KP's population expressed dissatisfaction with public sector health facilities in 2010,³⁹ while the average for Pakistan as a whole was 29 percent. Generally speaking, private health facilities were more likely to have appropriate health staff, though fewer had medicines available. Availability of medicines was generally low for both public and private health facilities.

Access to Basic Services

3.33 Overall access to basic infrastructure, including health facilities has generally improved in KP over the last 10 years though there are clear disparities among sub-regions and districts. While access to clean water and sanitary conditions has improved, the coverage is still low. Children's health is directly affected by the environment, which implies that children living in KP, and especially the service-starved regions, are at higher risk of falling ill or dying. Malakand and Southern sub-regions are again among the worst in terms of access to improved sanitation and drinking water.⁴⁰ Hazara and Malakand sub-regions have the worst access to health facilities probably due to overall underdevelopment of the regions and geographical challenges. There is also inequitable access to basic services across income quintiles, with the lowest quintiles having the worst access.

3.34 Access to public health programs also varies throughout the province, and by income quintile (Figure 3.18 and 3.19). The Prime Minister's Program for Family Planning and Primary Health Care was launched in 1994, with the LHWs program bringing health care closer to the population. LHWs are community-based workers, who work within communities and conduct home visits to provide information and guide mothers and children in appropriate and timely health practices. Survey findings suggest, however, that the LHW program may not be reaching its intended targets, notably the poorer income quintiles. The program is also not equitably distributed throughout: Malakand sub-region had the worst coverage in 2008 (Figure 3.20).

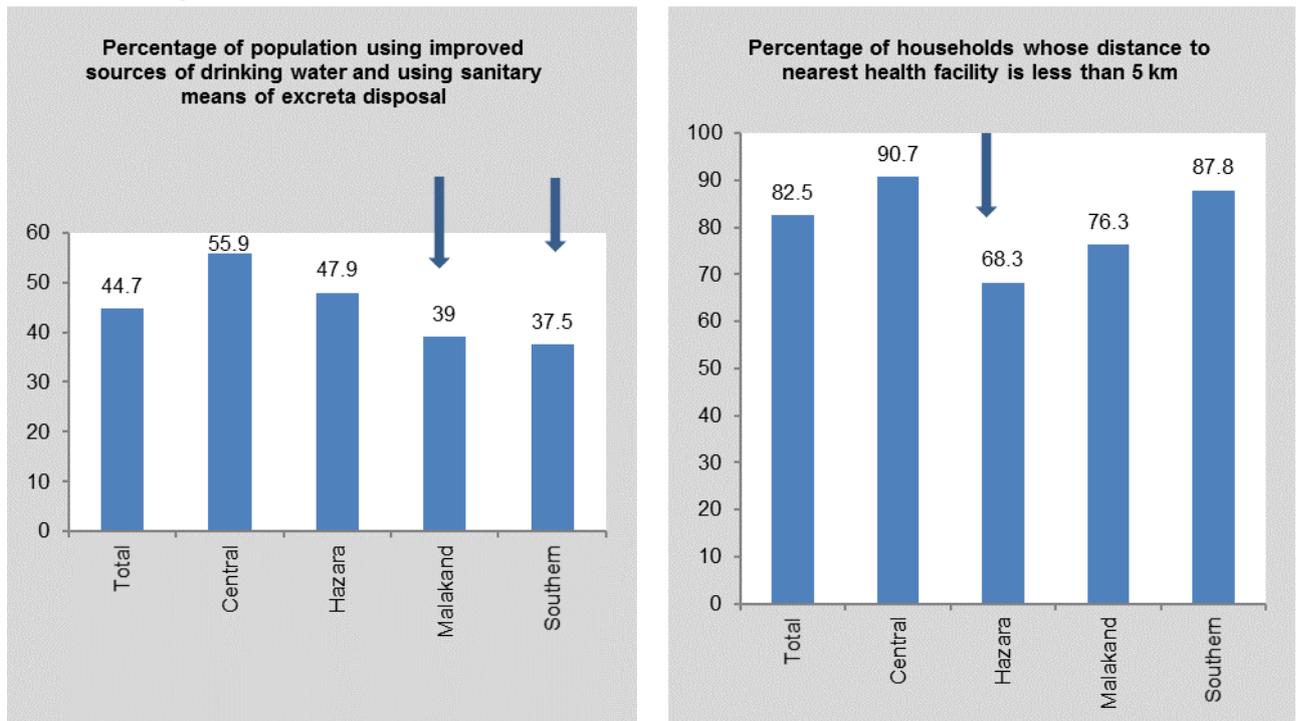
³⁷ UNDP April 2010.

³⁸ UNDP April 2010.

³⁹ UNDP April 2010.

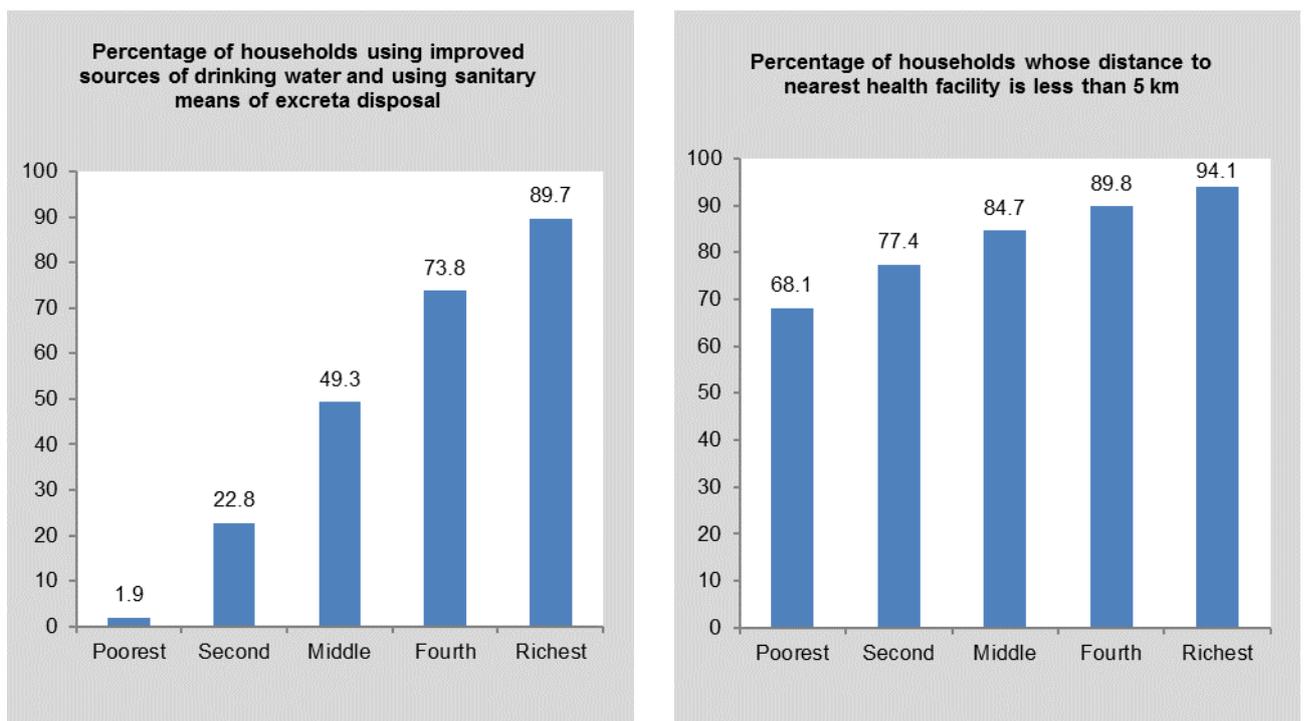
⁴⁰ K-MICS 2008.

Figure 3.18 Income Quintile Differential in Access to Basic Needs (2008)



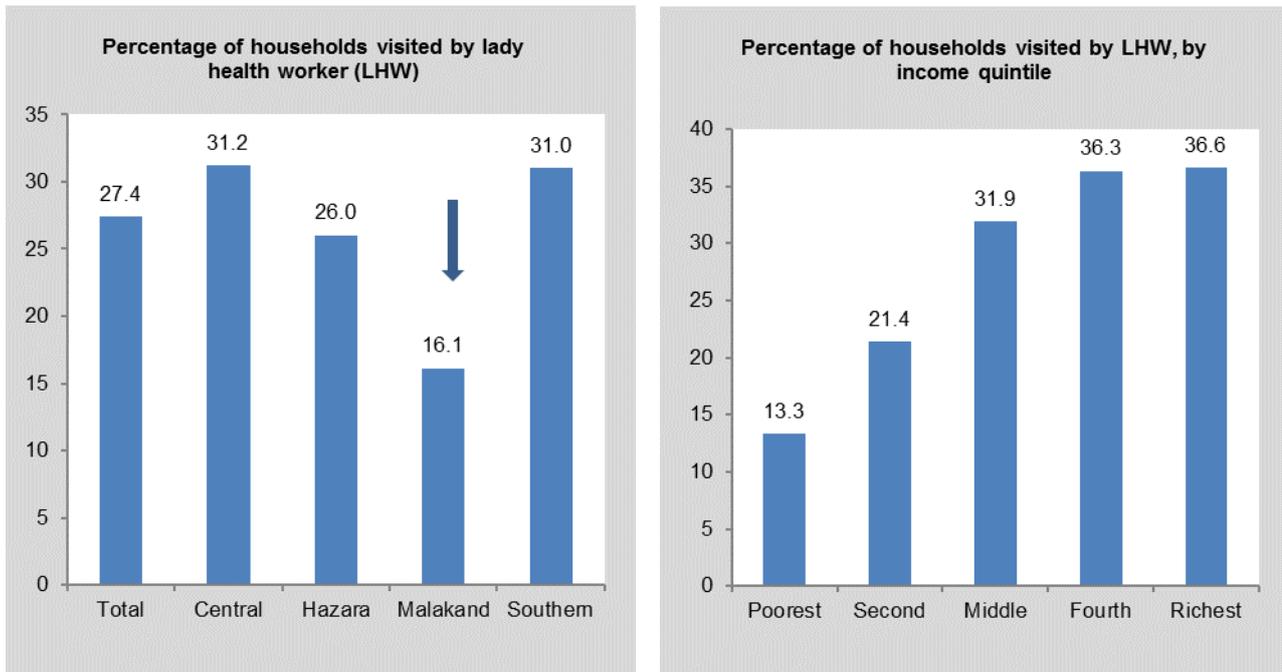
Source: K-MICS 2008

Figure 3.19 Income Quintile Differential in Access to Basic Needs (2008)



Source: K-MICS 2008

Figure 3.20 Performance of the LHW Program in KPK (2008)

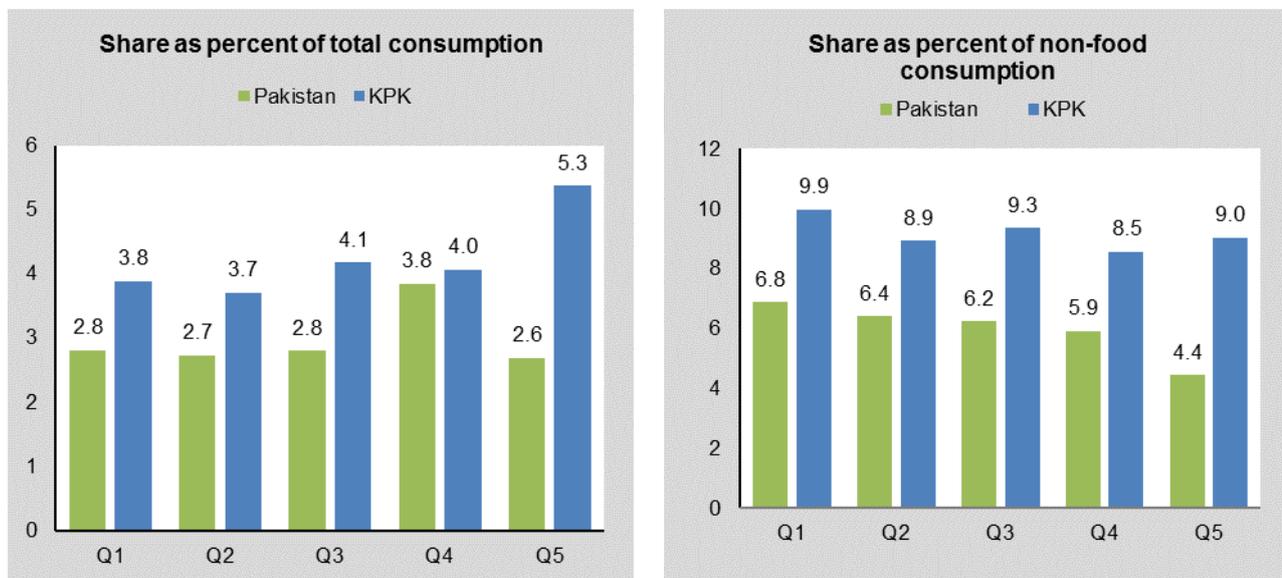


Source: K-MICS 2008

3.4 Household Expenditure for Health Care

3.35 Households in KP spend proportionally more on health than most households in the other provinces. Annual per-capita household health spending came to about Rs 1,400 in 2011, and Rs 680 per capita for the lowest income quintile. KP households across all income quintiles spent more on health than households in neighboring provinces (Figure 3.21).

Figure 3.21 Household Health Expenditure Share (% of consumption, 2011)



Source: PSLMS 2010-11

Note: Does not include travel costs

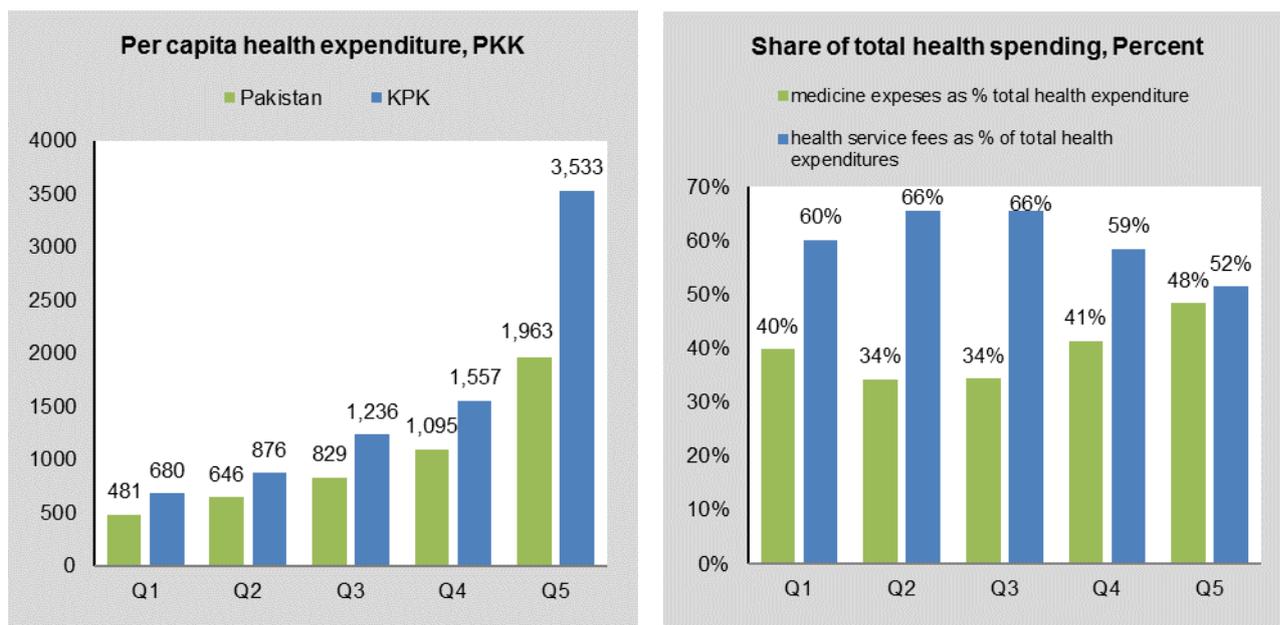


Figure 3.22 Household Health Expenditures for National Average and KP (2011)

Source: PSLMS 2010-11

Note: Does not include travel costs.

3.36 Households in the lowest income quintile devote a significant proportion of their spending to health care. International research has shown that the average household spends about 5 percent of its consumption share on health care. KP's average rate was 4.4 percent in 2011. However, the proportion jumps to 9 percent of average non-food consumption and to 10 percent (2011) for the poorest households, which are high rates by international norms. The health spending of KP's poor goes mainly on 'health service fees' (60 percent of their health spending in 2011). The public sector offers health care services at highly subsidized prices; however, it appears that households still report spending much on fees in both public and private sectors, including formal and informal payments.

3.37 Households in KP have high travel costs compared to those of other provinces. Although 83 percent of KP households live within one hour's reach of a health facility, they might be spending as much as Rs 340 per visit (2010)⁴¹—almost double the national average travel cost.

3.5 Public Health Expenditure

Health Spending in Pakistan: International Comparison

3.38 Pakistan's spending on health is relatively low compared to other countries with similar income (Figure 3.23). Total health spending increased to 3.36 percent of GDP in 2008, from 2.6 percent in 2006. Per-capita annual health spending was US\$35 in 2008. General government health expenditures are about 6.57 percent of total general government expenditures. The National Health Accounts (NHA 2008) reported that at national level private sector contributions amounted to 70 percent and out-of-pocket (OOP) was 63 percent, while public sector accounted for 25 percent of total health spending. The NHA results are available only for 2006 and 2008, which limits this analysis.

⁴¹ UNDP 2010.

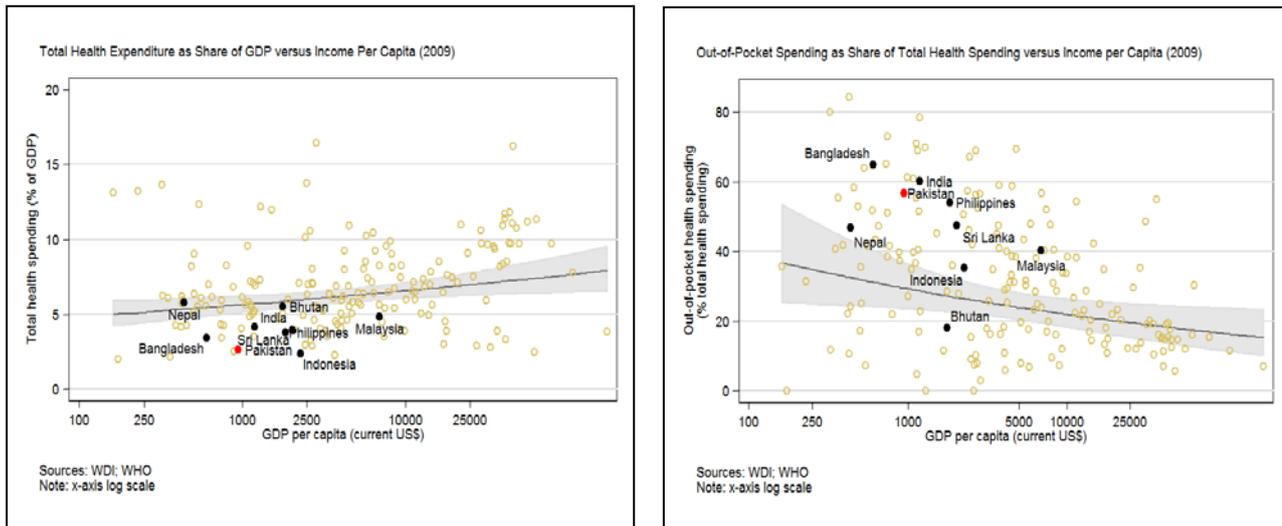


Figure 3.23 International Comparison of Health Spending Shares (2009)

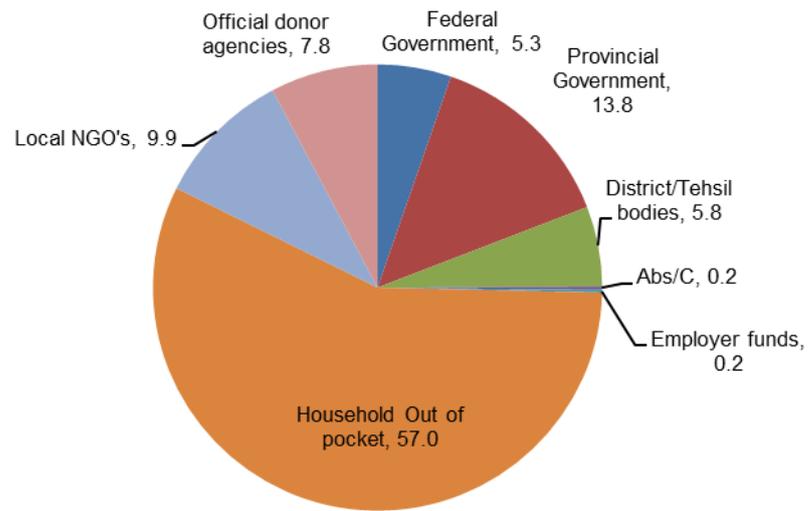
Source: World Development Indicator, World Health Organization

Public Sector Spending on Health: Inter-Provincial Comparison

Sources of Financing in KP

3.39 Total per-capita monthly health spending in KP has increased from Rs 112 (US\$1.90) in 2006 to Rs 194 (US\$3.20) in 2008. Private sector spending accounted for the largest share (67 percent) followed by public sector with 25 percent and official donor agencies with 8 percent.

Figure 3.24 Sources of Health Financing in KP 2007-08



Source: PSLMS

3.40 The public sector's share of total health spending has increased in KP. Total public sector contributions have increased, from 18 percent in 2006 to 25 percent in 2008, primarily due to increased investment on the development side by provincial government as part of the Structural Adjustment Credit (SAC) and Development Policy Credit (DPC)—the federal financing did increase during the time but it was limited to national program related expenditures. This suggests that a larger share of funds has been allocated to local authorities; while the federal government was still contributing significantly in 2008. Most of the funds were expected to go to vertical programs such as TB-DOTS, LHWs and international projects.

3.41 The total share of private sector spending has declined and new players have entered the market (Figure 3.25). The private sector's 67 percent share of health spending in 2008 was a decline from the share (77 percent) it held in 2006. The decline in the share of household contributions to 57 percent of total health spending in 2008 drove this reduction, while local NGOs' (new players) proportional contributions increased between 2006 and 2008. Local NGOs are expected to be active mostly at community level; they receive philanthropic contributions and/or resources from external grants. Some NGOs are also contracted by local governments under PPP programs to manage BHUs.

3.42 Total health spending in KP is more likely to increase when total government spending increases. A comparative analysis of spending in health services found a stimulatory relationship between the government's health spending and its total spending. Elasticity of total health spending to total government spending in KP was 1.16 between 2001 and 2011, showing that a 1 percent increase in government spending would likely increase total health spending by 16 percent. However, elasticity of total health spending was 0.74 for the period 2001-06, but 1.12 for the period 2006-11—agreater response in total health spending to total government spending in the second half of the period under review. The provincial allocations in KP, however, are greater than the rest of the country, because KP is more likely to receive additional funds for health spending (because of its greater socio-economic needs) while wealthier provinces get less to spend on health.

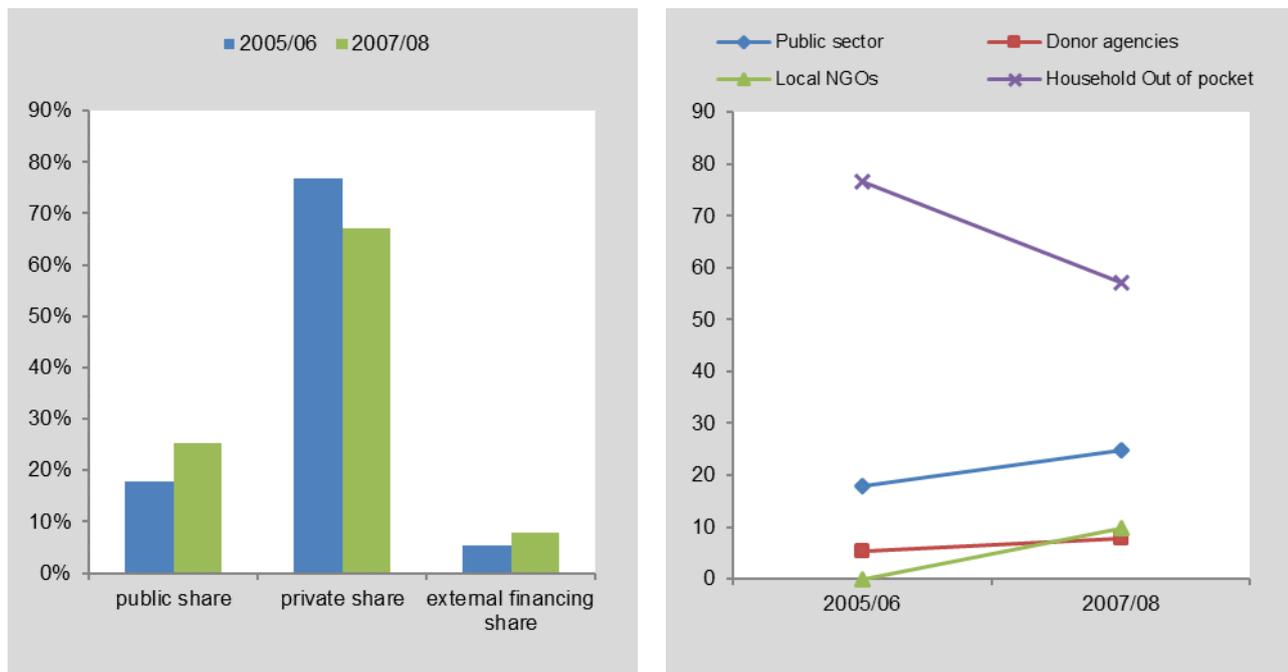


Figure 3.25 KP: Sources and Trends of Financing in Health Sector (2005-06 and 2007-08)

Source: National Health Accounts 2012

Table 3.2 Comparison of KPK Per-Capita Monthly Health Spending (2006 and 2008)

| Health Spending Indicators | 2005/06 | | 2007/08 | |
|--|--------------|------------|--------------|------------|
| | Rs million | Percent | Rs million | Percent |
| Public Spending | 5048 | 18% | 12784 | 25% |
| - Federal | | 3% | | 5% |
| - Provincial | | 14% | | 14% |
| - District/Tehsil bodies | | 1% | | 6% |
| - Autonomous/Corporations | | 0% | | 0.24% |
| Private Spending | 21634 | 77% | 34086 | 67% |
| - Employer fund | | 0.20% | | 0.20% |
| - Local NGOs | | 0% | | 10% |
| - OOP | | 77% | | 57% |
| Official donor agencies | 1495 | 5% | 3941 | 8% |
| Total | 28177 | | 50811 | |
| Population (m) | 20.9 | | 21.83 | |
| Per capita health spending, PKR (annually) | 1348 | | 2328 | |
| Per capita health spending, PKR (monthly) | 112 | | 194 | |
| Exchange rate | 60 | | 61 | |
| Per capita health spending, US\$ (monthly) | 1.9 | | 3.2 | |
| Per capita OOP (US\$, monthly) | 1.4 | | 1.8 | |

Source: NHA 2012; World Bank population estimates

Note: Autonomous bodies and corporations work under the administrative control of the federal / provincial governments. OOP refers to out-of-pocket expenditures.

KP Public Health Spending Trends

3.43 Public expenditure in KP is focused mainly on the social sector supporting health sector investment. Social sector investment increased to 3.5 percent of GDP during 2006-10 from 2.7 percent of GDP in 2000-05. Consequently, with the increased social sector investment, health sector spending also increased, albeit slowly, to 0.69 percent of GDP from 0.54 percent of GDP during the same period.

Table 3.3 Public Health Expenditure (% of GDP)

| | Expenditure: % of GDP | |
|------------------------|-----------------------|-------------|
| | 2000-2005 | 2006-2010 |
| General Administration | 1.4 | 1.7 |
| Social services | 2.7 | 3.5 |
| Economic Services | 1.3 | 1.4 |
| Community services | 0.8 | 1.1 |
| Transfers | 1.8 | 1.2 |
| Others | 0.6 | 2.3 |
| Total | 8.6 | 11.2 |
| Memo | | |
| Health and Population | 0.54 | 0.69 |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Comparison with Health Expenditures in Other Provinces

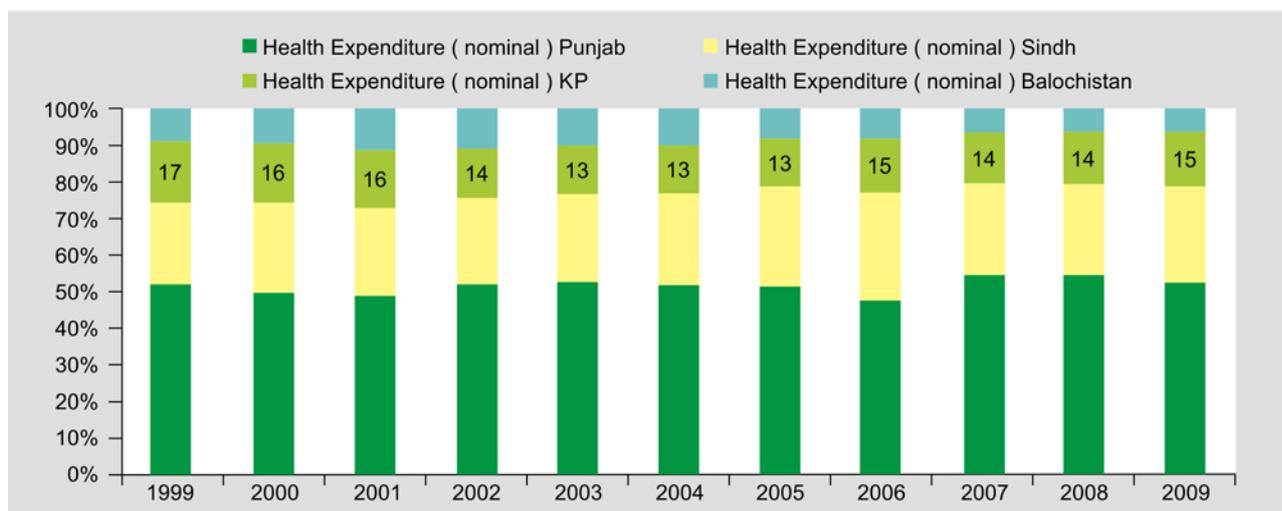
3.44 Health expenditure increased four-fold during 2001-10, but KP government's expenditure rate was below the national average. From 2001-10, aggregate provincial health expenditure was four times the average of preceding decade. KP's health expenditure growth during the last decade, although impressive at 3.4 times the previous decade's growth, was still slightly below national average.

Table 3.4 Average Health Expenditure (Rs millions)

| | 1990-2000 | 2001-2010 |
|-----------------------|-----------|-----------|
| Punjab | 4,225 | 18,243 |
| Sindh | 1,972 | 8,994 |
| KP | 1,470 | 4,994 |
| Balochistan | 1,002 | 2,636 |
| Provincial Aggregates | 8,669 | 34,866 |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

3.45 The KP government's share of expenditure on health is proportionately one-quarter of that of the leading province (Punjab) in health spending as a share of total spending (Figure 3.26). KP spends an equivalent of 15 percent of total provincial aggregate expenditure, while Punjab's and Sindh's health expenditures, the two highest, make up 52 and 25 percent respectively. These health expenditure levels set the benchmark by which other provinces might measure the investments required to improve health outcomes of their populations.

Figure 3.26 Health Expenditure—Provincial Share (%)

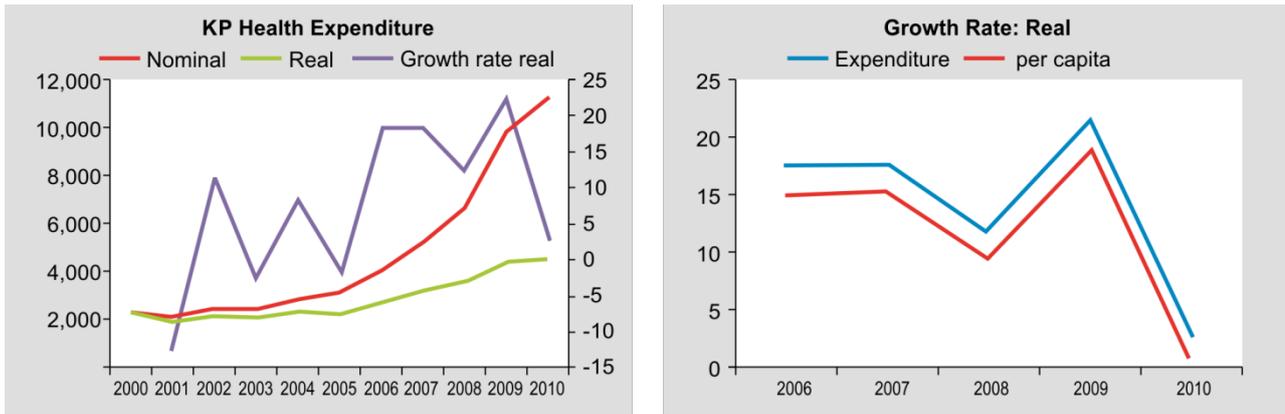
Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

KP Health Expenditure Status

3.46 The KP government's real health expenditure growth rate is in double digits and stable. The province's real health expenditure has been in double digits through the second half of the last decade, reaching 22 percent in 2009 when the provincial government boosted its health expenditure with some of the hydro-electric profits that were allocated to KP by federal government.

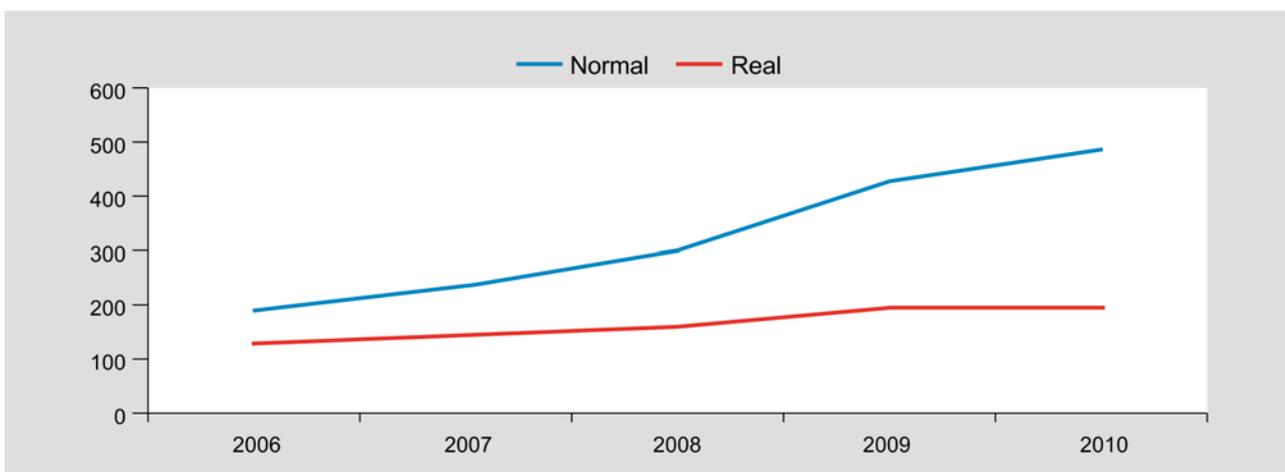
3.47 While KP's health expenditure continues to grow, the rate has slowed in recent years, and inflation is taxing inputs (Figure 3.27). Both real-term health expenditure growth rates—total and per capita—are increasing. Per-capita expenditure in real terms increased to Rs 195 in 2010, from Rs 127 in 2006. While still impressive, the rate of increase is declining: the per-capita growth rate in 2010 was half of one percentage point, down from 20 percent real growth in 2009. If this slowing in the per-capita expenditure growth rate continues, KP might miss health-sector outcome targets. In nominal terms, per capita health expenditure has increased three-fold, from Rs 191 in 2006 to Rs 482 in 2010, and much of this increase has come with an inflationary cost (Figure 3.28). Health sector expenditure doubled in real terms, to Rs 4 billion in 2010 from 2.2 billion in 2000. To maintain the level of real-term investment in health, and counter inflation, nominal health sector investment was increased eleven times during 2000-10, from Rs 2.3 billion to Rs 11.2 billion. Inflation tax on the health sector, therefore, is a large and very heavy burden.

Figure 3.27 Growth in KP's Health Expenditure



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Figure 3.28 Per Capita Health Expenditure

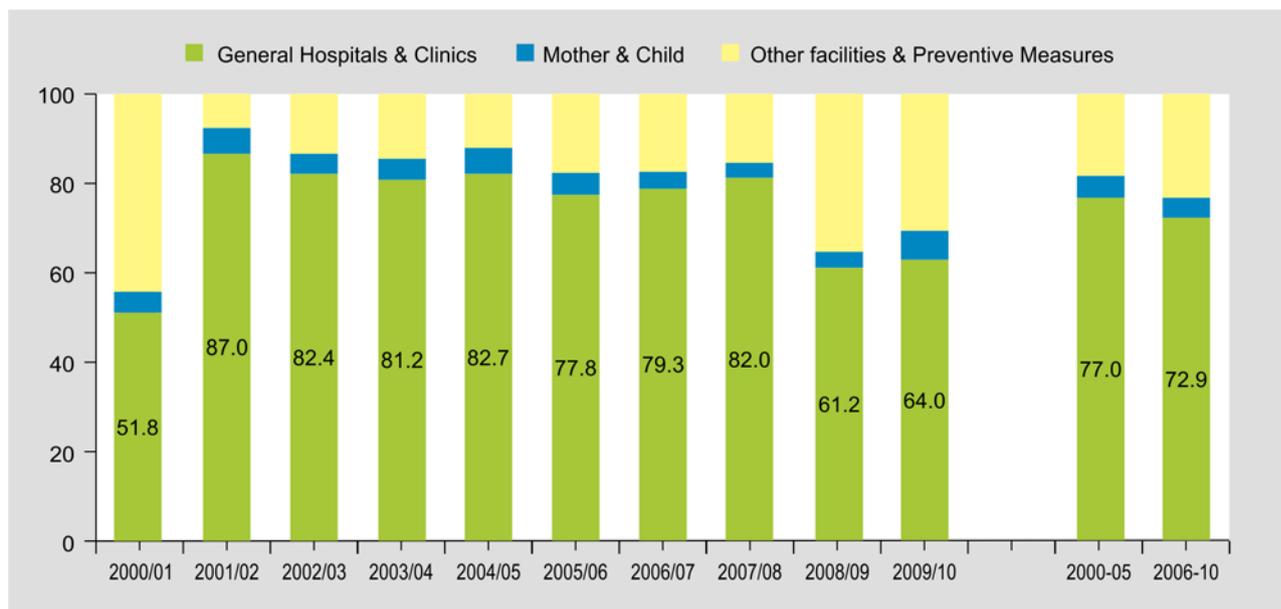


Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Health Expenditure: Functional

3.48 The main focus of KP's health sector expenditure is on tertiary care. Tertiary care (general hospitals and clinics) absorbed over 75 percent of total health expenditure in the province (Figure 3.29). The bias towards hospitals is prevalent at both provincial and district levels, and was most pronounced in 2011, reaching 84 percent, compared to 64 percent and 62 percent in 2010 and 2009.

Figure 3.29 Health Subsector Expenditure, % of Total Health Expenditure (2001-10)

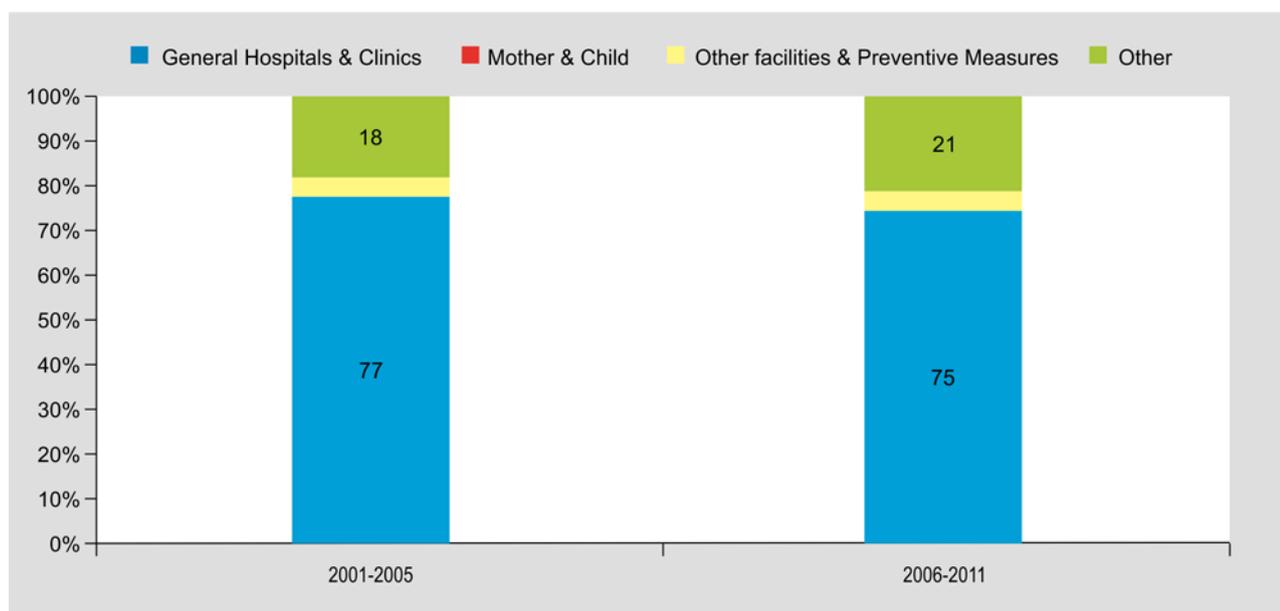


Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

3.49 The emphasis on tertiary care is crowding out other health service expenditure (Figure 3.30). The tertiary bias has crowded out expenditure in medicine, appliances and equipment, which make up less than 1 percent of total health expenditure. Meanwhile, spending on care for mothers and children accounted for less than 1 percent as most of MCH expenditures are being financed by federal national programs such as Lady Health Worker's initiative. This lack of attention to MCH services might explain the very poor outcomes in maternal and infant health. If not reversed, this neglect will tax medium-term growth and quality of life.

3.50 The lack of focus on mother-and-child health expenditure will come at the cost of missing MDG. Real public expenditure growth in this sub-sector has contracted, possibly due to an intra-sectoral tradeoff between tertiary care and essential care, and direct federal intervention in the latter that is not reflected in the provincial expenditure records. Spending on MCH care needs to be improved as a matter of urgency. This is also partly due to large federal expenditures in MCH supported through national programs.

Figure 3.30 Percentage Subsector Share in Health Expenditure



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Health Expenditure: Economic Classification

3.51 Current expenditure makes up half of health expenditure and mainly funds personnel costs. The share of recurrent expenditure is 50 percent of total health expenditure, with the personnel cost (remuneration and benefits) close to 49 percent. Capital expenditure is on average 29 percent of total health expenditure of which 24 percent goes towards civil works. Local government receives 22 percent of total health expenditure in the form of transfers.

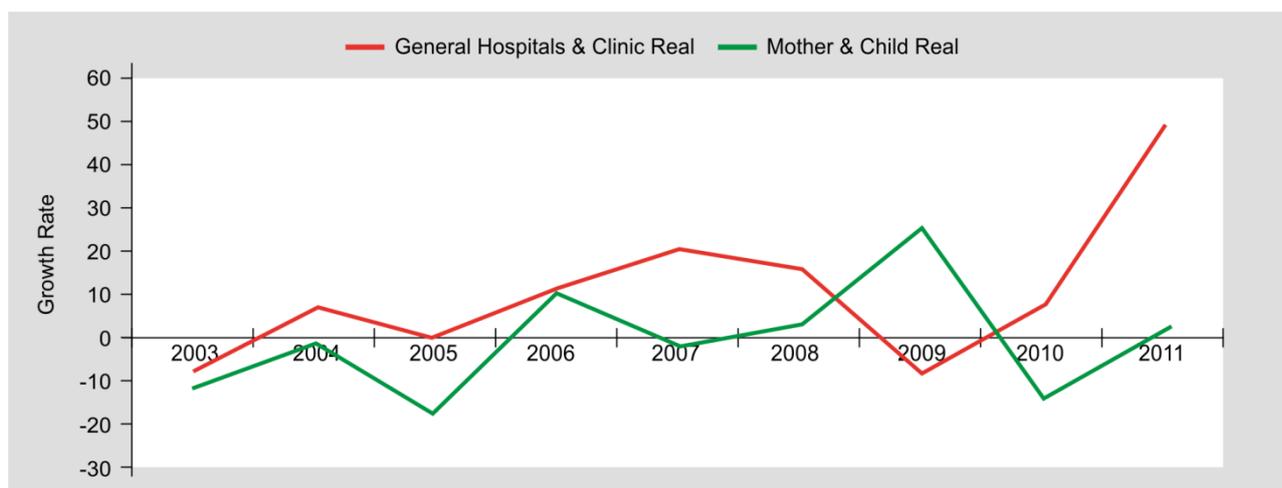
3.52 Capital expenditure is the largest expenditure category at provincial level. More than 40 percent of provincial health expenditure is capital expenditure, and over 37 percent goes towards civil works. Another 31 percent is spent through transfers from province to districts, much of which is difficult to place in accounting records and therefore subject to poor governance.

3.53 District-level expenditure is entirely current. District-level health expenditure is made up entirely of remuneration, leaving very little space to fund other activities.

3.54 Absorption capacity of development expenditure needs improvement. The absorption capacity⁴² of the health sector is within a 75-80 percent range for use of allocated funds, with low disbursements on development funds and recurrent expenditure fully spent. The ratio of recurrent to development expenditures in total health sector is 65:35 respectively.

Figure 3.31 Health Subsector Expenditure (Real) Growth Rate

⁴² Use of money.



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Table 3.5 Health Expenditure—Functional (Share in Total Expenditure)

| | 2008 | 2009 | 2010 |
|--|-------|-------|-------|
| Medical products, appliances and equipment | 0.13 | 0.14 | 0.14 |
| Hospital services | 84.93 | 83.83 | 84.34 |
| Public health services | 10.00 | 11.00 | 8.39 |
| Health administration | 4.95 | 5.03 | 7.14 |

Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

3.55 Devolution is a policy on paper only. In absence of unit costs linked to outputs, low levels of discretionary funds and a high share of recurrent cost commitments as a share of total expenditure (99 percent), districts are heavily dependent on provincial and federal governments for funding development activities. At provincial level the ratio of recurrent to development expenditure is more favorable for development i.e. 55 percent of provincial health expenditure.

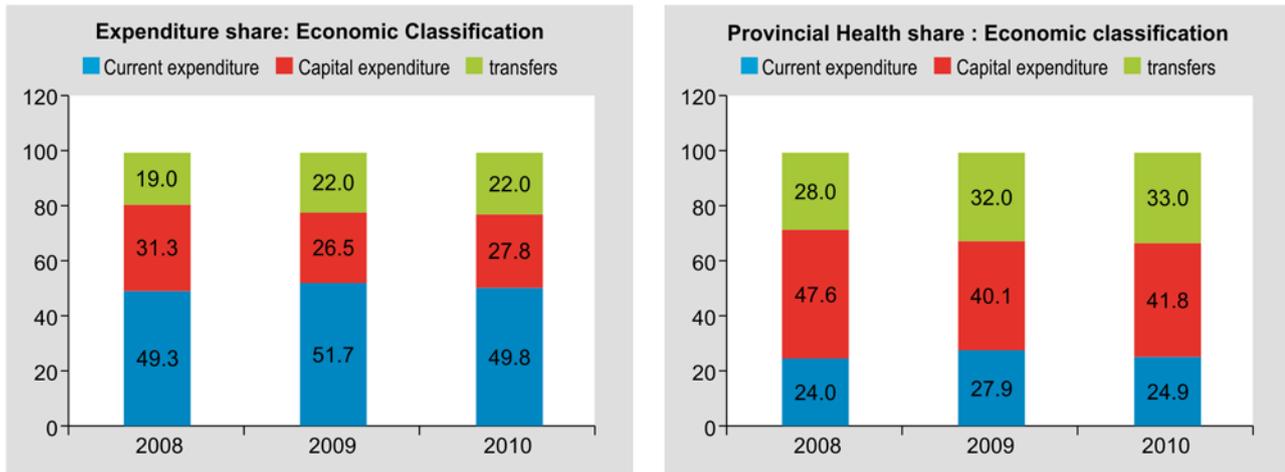
3.56 External financing is part of health development spending and has been fluctuating, with significant reductions in 2010. Past assessments of KP⁴³ show that external financing is a small proportion (5.3 percent in 2006 rising to 8 percent in 2008) of total health spending, and as much as 25-30 percent of public sector health spending. The public sector relies on external financing under its development budget for capital investments and for the financing of several goods, such as family planning commodities, vaccines and drugs.

3.57 Overall, districts receive a steady allocation of consolidated provincial health spending. Districts received 33 percent of total provincial (consolidated) health spending, although, individual district allocations are variable, based on decisions taken by the provincial authorities. Wide variation is seen in district health spending.

3.58 Districts allocations. While Swat receives the lowest per capita allocation (Rs 242 in 2011), Peshawar receives at least nine times more per capita. As provincial capital Peshawar houses the provincial administration and several autonomous bodies and corporations. Over half of the districts spend below the provincial average on health i.e. Rs 460 per capita in 2011.

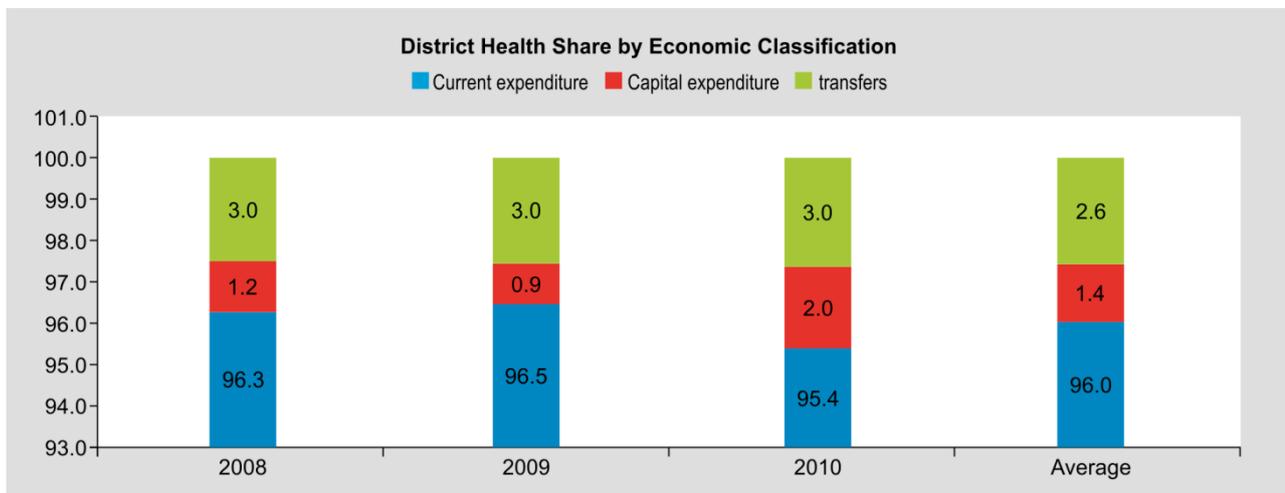
Figure 3.32 Expenditure Share and Provincial Health Share by Economic Classification

⁴³ Notably NHA 2005



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

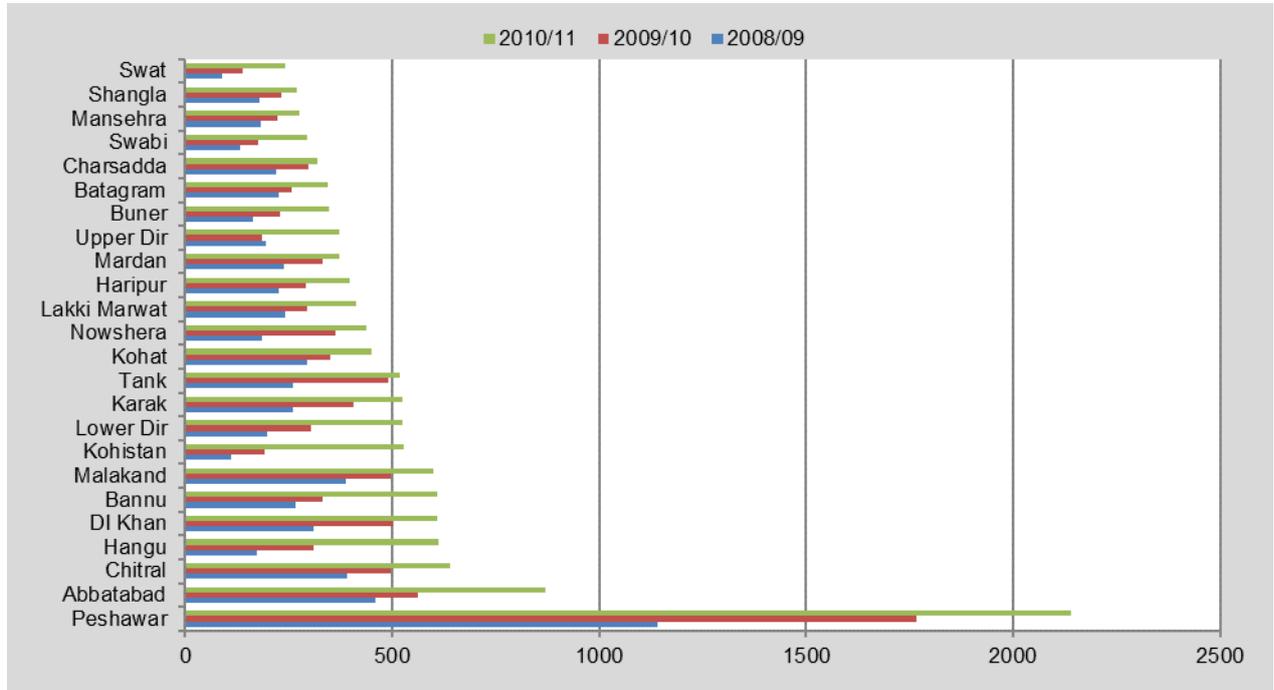
Figure 3.33 District Health Share by Economic Classification



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

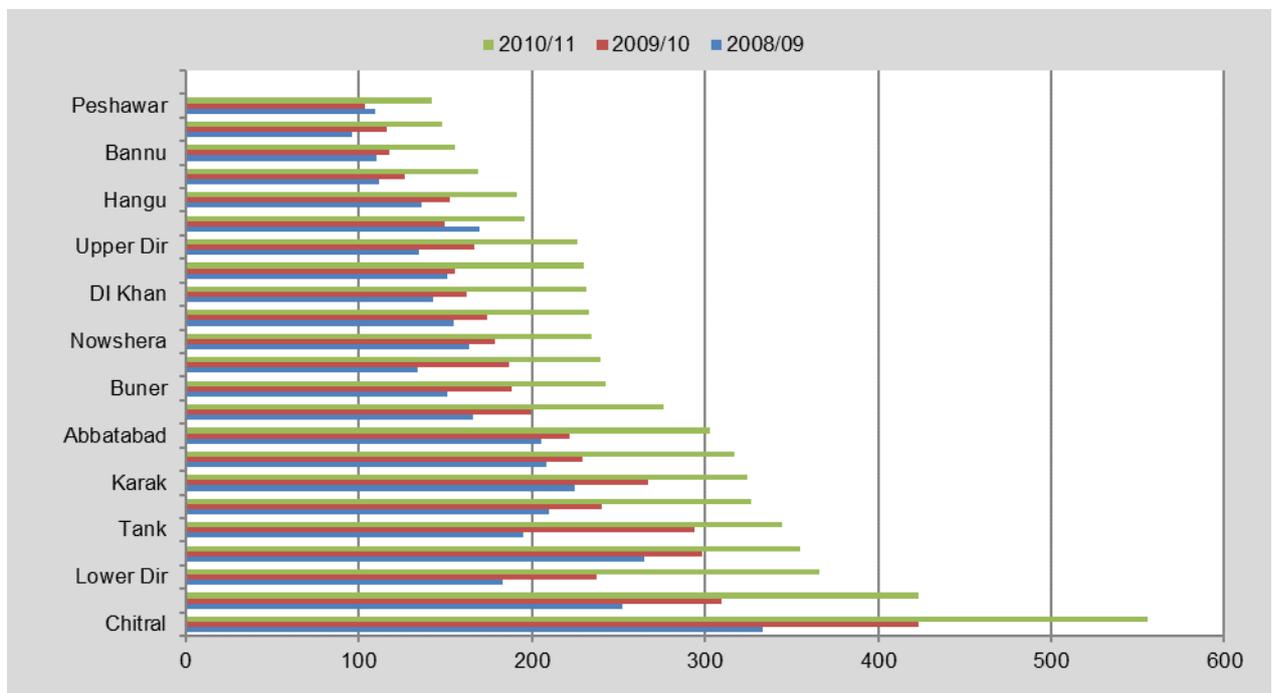
3.59 District health spending (based on allocations) is highly variable (Figure 3.34 and 3.35). A set formula is used for per capita allocations from provinces to districts, based on economic disadvantage and lag in infrastructure. Chitral has the highest per-capita district health spending (Rs 556 in 2011) while Peshawar has the lowest (Rs 142 in 2011). About one-third of the districts (seven) fall below the mean for per-capita district health spending, although the overall spending increased by 12 percent between 2009 and 2010, reflecting the inflationary increase, and 34 percent between 2010 and 2011, due to increased NFC Award.

Figure 3.34 District Per Capita Health Spending—District and Provincial Public Allocations (Rs)



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations
 Note: This includes all of health sector spending including provincial and district shares for the district.

Figure 3.35 District-level Public Per Capita Spending in Health—Only District Allocations (Rs)



Source: Finance Department, Government of Khyber Pakhtunkhwa and WB staff calculations

Note: This includes all of health sector spending including provincial and district shares for the district.

Efficiency in Public Health Spending

3.60 Overall the low public allocation for health is not an issue. Recurrent budget execution in KP is good, but development budget execution is low. Remunerations are sent directly to individual civil or public service accounts monthly, while non-salary recurrent budgets are released twice a year (50 percent in July and 50 percent in February to match the July-June fiscal year). However, it was noted that provincial administration often under spends, while district administrations tend to overspend. Under spending was noted in remuneration and operations. Overspending was noted in MCH services, which receives very low allocations to begin with. The Department of Finance may permit supplementary spending during the year if the overall budget is almost spent. However, there is no period in this analysis where the total consolidated provincial health budget was overspent.

3.61 Health spending patterns seem to indicate low allocative efficiency, as a disproportionate share of public health spending goes towards expensive curative interventions at hospitals, and an insufficient share goes towards the less expensive and cost-effective programs in public health and private health goods. Interventions with substantial externalities such as immunization and family planning remain underfunded, resulting in underperformance regarding the MDG. Limited financing and support for health promotion and behavior change programs have resulted in low demand for critical services such as children with diarrhea receiving oral rehydration therapy (ORT), which is a more cost effective in preventing dehydration than intravenous or treatment protocols with drugs for dehydration. Health indicators show that unmet need for contraceptives remains high in some districts and within the lower income quintiles. Other basic cost effective interventions, such as immunization, have low overall coverage, especially in some districts and within lower income quintiles.

3.62 Health service use patterns do not show technical efficiency. For example, expectant mothers are going to doctors for normal deliveries, whereas, this could easily be handled by trained midwives and nurses, who serve closer to the communities and have much cheaper input costs. Children with suspected pneumonia tend to go to private health care providers, if they go at all, because of a general perception that the quality of private care is superior. However, private providers are often more costly than the highly-subsidized public sector health programs. Families tend to bypass clinics (especially BHUs) in favor of hospitals. Specifics are not available, but generally households in KP seem to be less satisfied with the delivery services in public facilities, because of inadequate staffing and medicine supplies. Better staffed and equipped BHUs, which are generally located near to the communities they serve, would be a cost effective solution. The efficiency side of public health services was not assessed, given the limited health service use data, especially hospitals' per-capita costing, bed occupancy and cost of outpatient hospital care compared to that of clinics. This information is crucial for assessing and recommending ways to improve efficiency and such studies should be prioritized.

3.6 Public Sector Budgeting Processes

3.63 Historical budgeting leads to limited planning and limits incentives for staff to be accountable for their performance. KP uses the process of incremental (also known as historical) budgeting by line items, which means that budgets do not necessarily reflect needs. The historical budgeting process is widely used in the public sector across Pakistan. It is a simple, easy process based on cash accounting, and orients towards control. Budgets are prepared by the sectoral ministries using historical budget information, and within the new revenue constraints put forward by the Ministry of Finance (for current budgets) and the Planning Commission (for development budgets). Recurrent and development budgets are not linked in preparation discussions or in execution. The next year's recurrent budgets would most probably include the previous year's recurrent budget (not actual spending) and the supplementary appropriations, and add to it inflationary adjustments. It may therefore not accurately reflect needs. Recently,

however, the KP Department of Health (DOH) has begun to experiment with output-based (or performance-based) budgeting processes, and expects to scale up its use.

3.64 Performance budgeting can help establish a link between public spending and service delivery and assist in making performance auditing more coherent. Further evaluation and closer monitoring is required of those districts that are experimenting with output-based budgeting to learn how the process and negotiations are benefiting allocations, how allocations are changing in favor of some programs, and how coverage and ultimately performance would change.

3.65 Line item or historical budgeting does not allow for easy accounting for changes in activity as funds are not fungible. The budgets are monitored under the following object classifications: (a) employee-related expenses, (b) operations and maintenance, (c) grants, subsidies and transfer payments, and (d) physical assets/civil works. Each of these line items is further separated under the following functional classifications: (i) hospitals and clinics, (ii) MCH program, (iii) laboratory and drugs, university-related expenses, and (iv) administration. If a particular item in the budget is under spent, the sectoral ministries cannot easily transfer the unspent funds to other budgeted line items. Capital investment funds cannot be transferred to recurrent budgets, and remuneration funds cannot be transferred to any other line item. However, unused resources don't seem to be lost to the sector in that particular year, as supplementary appropriations are made during the year for the overspending within the current budget line items. Global budgeting could be one way to improve efficiency and transparency of budget use.

3.66 The line item budgeting process may have stifled incentives to fill vacant sectoral posts. Budgets for remuneration are based on total number of sanctioned positions given to a sector, not on how many have been, or might be, filled. This way, even if posts are not filled in a particular year, the budget is not lost from future budgets. It is not clear what incentives, if any, such a system created for sector managers to fill the vacant post quickly, or even whether the sanctioned posts are still required.⁴⁴ On the supply side, it may be that it was too difficult to fill unfilled posts in rural and remote areas because of political and social volatility within the province. The question of payments for 'ghost' workers or 'absenteeism' was not available for this review. It is also not clear if the incentives offered for rural postings actually materialized. This review shows that a significant proportion of remuneration spending is under spent, and yet remunerations ('Item 1') as a category is not fungible and cannot be reallocated to other budget items. It may be more prudent for future employee-related expenses to be based on actual posts, thereby improving efficiency in the use of funds and providing incentives to fill the vacant sanctioned posts.

3.7 Recommendations

3.67 Especially given the severely adverse circumstances caused by insecurity and multiple natural disasters KP has made remarkable progress in health service delivery. However, increased focus of health sector expenditure towards basic services will increase the sector's performance. The following recommendations are aimed at achieving the MDG and increased demand for and coverage of such basic health services as MCH, nutrition and family planning:

- KP needs a health sector strategy that should be anchored by the MTBF for better planning and implementation. The KP health sector strategy must calibrate the unique characteristics of KP's districts and be anchored in the MTBF so that ex-ante planning and budgeting processes focus on district-specific outcomes. The attainment of area-specific health outcomes may require focused care and diagnostics, contracting out outreach programs to non-state agencies, and intra-health-sector budget reallocations to meet specific goals spelled out in the sector strategy.
- Inequalities in health service provisions need to be addressed. Budget allocations are based on incremental formulas and are declining in real terms. The artificial splitting of current and development expenditures tends to

⁴⁴ Historical data on vacant positions 'ghost' workers or 'absenteeism' were not available for this review.

exacerbate existing inequalities and stifles progress in health service provision. There is a need to move away from the current system of budgetary allocation to one which is based on the size and needs of the beneficiary, cost of service delivery, and ability to reduce social inequalities.

- A public-private partnership (PPP) plan for health care and its implementation could expand the existing coverage of public health services. KP households spend an unduly high proportion of their expenditure on health services. A PPP health policy, with enabling legislation—setting out clearly the responsibilities and roles of state and non-state players in the provision of health service—could encourage existing medical colleges to expand their outreach programs, and in turn encourage the medical profession, especially in tribal areas, to provide services that are currently unavailable in the economic and security circumstances. Pilots could be implemented to test such hypothesis.
- An inter-ministry coordination committee should be established to facilitate the delivery of health services. Inputs from various ministries and agencies connected to health services—for instance, roads, telecommunications, drinking water and female education—would expand the utility and utilization of existing health services. More importantly, their involvement would ensure better and more effective planning and expanded coverage of health services.
- The province needs a financing plan for the sector capturing additional financing needs of national programs in the post 7th NFC time period—it would be important for the province to start increasing its investment in the sector. The proposed strategy envisages huge external resources investment which is not realistic
- A critical area of weakness which has not been mentioned is lack of results-based system or culture in the sector. The sector needs to make the system more results oriented and produce data to measure results—it needs to invest extra in monitoring and evaluation in order to measure results and tie district financing with performance.

Annexes

Annex 1: Estimation of Provincial GDP

As in most developing countries of the world, in Pakistan too, the calculation of Gross Domestic Product (GDP) contains some methodological weaknesses. Two of the most obvious shortcomings are the periodicity (the national accounts are compiled on annual basis only) and aggregate nature of these accounts. While the National Strategy for Development of Statistics calls for preparation of quarterly GDP at the national level and of annual regional accounts at provincial level; it would be quite some time when the work on these initiatives would start. Till such time, these shortcomings would continue to hamper monitoring of national aggregates at national level and regional planning in the country.

Until 1971 Pakistan had a centralized system of administration—the ‘one unit’ system—under which no distinction was made between various geographical and cultural entities within the region called West Pakistan, which later came to be known post-1971 as Pakistan. Hence no need was felt to estimate Regional Accounts. In 1971 the ‘one unit’ was broken into four separate administrative units or provinces, the Punjab, Sindh, Khyber Pakhtunkhwa and Balochistan. However, even under this new system relatively little autonomy was given to the provinces, as major decision-making authority de-facto remained at the Federal level. Until the early eighties, Pakistan’s GDP was estimated with the base year of 1959-60. In the early 1980s, the base year was changed to 1980-81, and in early 2000s the base was again changed to 1999-00, which had continued till today.

Economic analysis of the province, as that of any other province, is seriously compromised by the non availability of regional accounts. While the Pakistan Bureau of Statistics (PBS) computes, on annual basis, the national accounts of Pakistan,⁴⁵ only cursory efforts have been made to estimate the regional accounts. Most of the attempts made at official levels were aborted because lack of interest at the relevant segments of the government and weak technical capacity of the provincial Bureaus of Statistics to undertake this exercise. On the other hand, exercises undertaken by autonomous researchers failed to get the required recognition from the government. Making use of the methodology adopted by these researchers, this note makes an attempt to estimate the regional accounts of Punjab.

The construction of provincial GDP series is a large and complex undertaking, as disaggregated data are needed for a very large number of province-specific variables. Moreover, the exercise is also extremely time intensive, as a large volume of data need to be analyzed to derive consistent and robust estimates. In the past, the World Bank has endeavored to estimate provincial GDPs by using some broad ‘allocators’ to derive the shares of each province in sectoral value added and the national income. In doing this, provincial GDP was estimated using a combination of three traditional approaches—production, expenditure or income. More specifically, wherever detailed provincial

⁴⁵ Attempt is being made to derive the national accounts on quarterly basis.

data were available, for example, agriculture, mining and quarrying, manufacturing, and wholesale and retail trade, sectoral value added were estimated using the production approach. The expenditure approach was used to compute value added of the construction, ownership of dwellings, electricity and gas distribution, and public administration and defense subsectors, whereas a variant of the income approach was applied to estimate value added in the transport, storage, communication, banking and insurance, and services subsectors. In almost all of these instances, the direct and indirect methods were combined to compute sectoral value added by apportioning the national income to the province using appropriate allocators. While these allocators were applied only where disaggregated data at the provincial level were not available, clearly the present exercise represents the 'second-best' approach to estimating sectoral value added at the provincial level.

Methodology:

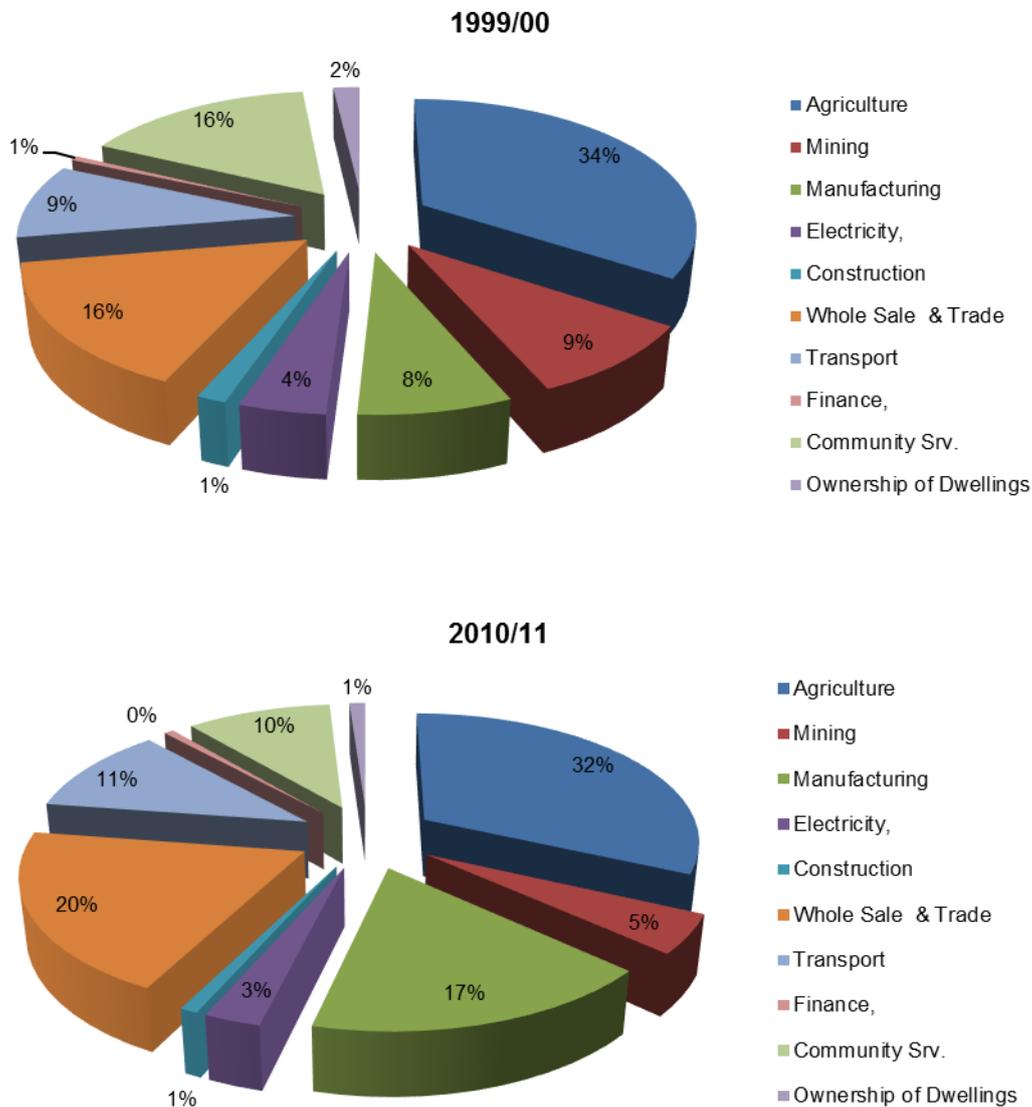
In order to estimate provincial GDPs for the Economic Assessment of 2012, the following data sources have been used:

- Agricultural Statistics of Pakistan, of various years
- Pakistan Statistical Yearbook 2011
- Economic Survey of Pakistan 2010-11
- Labor Force Survey 2011
- Household Integrated Economic Surveys (HIESs) for 2005-06, 2007-08 and 2010-11
- Pakistan Energy Year Book, 2011
- National Institute of Population Studies: estimates/forecasts of annual provincial population
- Livestock Census of 1996 and 2006

The Agricultural Statistics of Pakistan was used as the main source for actual production of the major and minor crops. The crops have been selected in compliance with the national rebasing exercise of 1999-00 done by the then Pakistan Bureau of Statistics. The Pakistan Statistical Year Book of 2011 along with its previous years' publications and the Household Integrated Economic Surveys (HIESs) for 2005-06, 2007-08 and 2010-11 were used as the prime databases.⁴⁶ While the Statistical Year Books provide most of the actual data in the analysis, the HIES provides sectoral sources of household income. The Labor Force Surveys was useful to extract data on labor force and sectoral employment etc. The Energy Year Book provides information on the Energy sector production and the prices/cost of generation. Information on National GDP, its deflators, Consumer Prices etc. is pulled together from the Economic Survey of Pakistan. The National Institute of Populations Studies provided the Bank few years back, the estimates of provincial population and its forecast for future years, based on the 1998 population census. On requesting the newer set of data on Population estimates, it was stated that since there is no new census after 1998, the same estimates are being used for various analyses.

⁴⁶ For the years when no HIES was conducted, i.e. 2006-07, 2008-09 and 2009-10, the estimates were obtained by interpolation.

Annex Figure 1.1 Comparison of Sectoral Share of KP GDP (1999-00 & 2010-11)



Source: National Accounts data and WB staff calculations

The sector-wise methodology is discussed below:

Agriculture: Value added in agriculture in all provinces has been estimated by applying provincial allocators to the national value-added estimate for this subsector. Overall, the computation of value added in crop agriculture is based on 12 major crops and 8 groups of minor crops. The groups are classified as pulses, vegetable, fruits, condiments, oilseed, flower and foliage, fodder and other miscellaneous crops. The crop output data for the provinces and for Pakistan was obtained from published sources.⁴⁷ Due to the non availability of input costs of agriculture, production

⁴⁷ The data are obtained from various issues of the Pakistan Statistical Yearbook, Agriculture Statistics of Pakistan, Provincial Development Statistics, Economic Survey, Agricultural Crops and Livestock Products—Long-Term Trends, and Support Price Policy Issues of Major Crops.

allocators were used to estimate value added for the crop subsector. Every province share of total crop production in national output was assumed to remain the same as its share of total national value added. These output shares (allocators) were used to estimate value added of wheat, rice, cottonseed, sugarcane, maize, gram, barley, jawar, bajra, rapeseed and mustard, sesame seed and tobacco for major crops for the years 1999-00 to 2010-11. The simple addition of the value added of each crop represents the total value added of major crops. Similarly, value added of minor crops was estimated using lentils (mash, moong and masoor), potatoes and onions, oilseeds, fruits etc. as the main minor crops.

Annex Table 1.1 KP Gross Value Added of Agriculture Sector (at Constant Factor Cost)

| | Major crops | Minor Crops | Livestock | Forestry | Fishery | Total Agri |
|---------|-------------|-------------|-----------|----------|---------|------------|
| 1999/00 | 19,818 | 10,850 | 31,480 | 13,550 | 61 | 75,759 |
| 2000/01 | 17,033 | 10,200 | 32,019 | 13,837 | 64 | 73,154 |
| 2001/02 | 18,464 | 9,778 | 32,358 | 17,699 | 65 | 78,363 |
| 2002/03 | 19,749 | 10,253 | 30,388 | 15,710 | 115 | 76,215 |
| 2003/04 | 19,169 | 10,138 | 30,512 | 5,769 | 143 | 65,731 |
| 2004/05 | 20,547 | 9,948 | 34,221 | 12,125 | 147 | 76,988 |
| 2005/06 | 19,359 | 9,817 | 42,448 | 14,947 | 191 | 86,761 |
| 2006/07 | 21,324 | 10,145 | 44,166 | 11,726 | 764 | 88,125 |
| 2007/08 | 20,317 | 10,234 | 41,254 | 9,692 | 217 | 81,715 |
| 2008/09 | 21,756 | 9,805 | 43,909 | 9,747 | 290 | 85,506 |
| 2009/10 | 20,089 | 8,875 | 47,926 | 9,961 | 382 | 87,234 |
| 2009/11 | 16,645 | 12,184 | 52,930 | 9,921 | 505 | 92,186 |

Source: National Accounts data and WB staff calculations

Annex Table 1.2 KP Share of National Agriculture Value Added (at Constant Factor Cost)

| | Major crops | Minor Crops | Livestock | Forestry | Fishery | Total Agri |
|---------|-------------|-------------|-----------|----------|---------|------------|
| 1999/00 | 5.8 | 8.6 | 7.5 | 57.8 | 0.4 | 8.2 |
| 2000/01 | 5.5 | 8.4 | 7.4 | 54.1 | 0.4 | 8.1 |
| 2001/02 | 6.1 | 8.3 | 7.2 | 72.4 | 0.5 | 8.7 |
| 2002/03 | 6.1 | 8.6 | 6.6 | 57.9 | 0.9 | 8.1 |
| 2003/04 | 5.9 | 8.2 | 6.4 | 21.9 | 1.1 | 6.8 |
| 2004/05 | 5.3 | 7.9 | 7.1 | 68.2 | 1.1 | 7.5 |
| 2005/06 | 5.2 | 7.8 | 7.6 | 84.9 | 1.2 | 7.9 |
| 2006/07 | 5.3 | 8.1 | 7.6 | 70.2 | 4.0 | 7.8 |
| 2007/08 | 5.4 | 7.4 | 6.9 | 66.7 | 1.0 | 7.1 |
| 2008/09 | 5.4 | 7.1 | 7.1 | 69.2 | 1.4 | 7.2 |
| 2009/10 | 5.1 | 7.0 | 7.4 | 69.2 | 1.8 | 7.3 |
| 2009/11 | 4.4 | 9.2 | 7.9 | 69.2 | 2.3 | 7.6 |

Source: National Accounts data and WB staff calculations

Livestock: The livestock subsector includes the value added of actual livestock population, including the newborn. The census livestock population was available for 1996 and 2006 while the other years were estimated by the provincial share of livestock value of the national value of livestock in the census year under consideration. Actual data on slaughtering, poultry and milk was also taken into account while calculating Livestock value of each province. The weight of each product in total value added was derived from the national accounts data.⁴⁸

Fishery: The provincial value added in the fishery sector is derived from the national value added in the sector by using the provincial share in total fish production as weight.

Forestry: The major component of forestry is timber and firewood production. The value added of this sector was assumed to be proportionate to the timber and firewood production shares of Pakistan production of timber and firewood. The constant share of 1999-00 is used to draw the final estimates. In other words, the provincial value added in the forestry sector was derived from the national (sectoral) value added by using the production share of Timber and firewood to the national shares multiply with the 1999-00 prices of these productions.

Manufacturing: The manufacturing subsector is subdivided into large-scale and small-scale manufacturing. Large-scale manufacturing includes units that employ 20 or more workers on any working day during the year and use power, while the small-scale manufacturing includes those units that employ 10-19 workers in any day of the year.

Value added in the provincial large scale manufacturing subsector is estimated on the pattern of national GDP calculations by PBS based on the Census of Manufacturing Industries data and the Quantum Index of Manufacturing (QIM) estimates. The provincial Bureau of Statistics conducts monthly surveys of industrial production and employment in their respective provinces and estimates QIM based on these data. The survey reports cover about 90 percent of the total industrial units. The methodology used to estimate the monthly index was to measure the percentage increase in the current month's production of any item from the average monthly production of 1999-00. The weighted percentage increase was calculated with the assigned weights based on 1999-00 CMI data for each item.

The benchmark estimates (1999-00) of large scale manufacturing value added are derived on the basis of provincial shares of value added from the CMI for the census years. The CMI data has its deficiencies of time lag, considerable non-response, underreporting of output value and over-reporting of input cost (supposedly due to fear of taxation), and under-coverage of non-registered companies. However, despite these shortcomings the CMI data were used assuming that data problems in all provinces were no different to those at national level. The benchmark data points obtained from the CMI were then interpolated for the years where the CMI was not conducted using the annual percentage increase in provincial QIMs.⁴⁹

The small scale value added, which includes value added on Slaughtering, has been estimated based on the Census of Small Household Manufacturing Industries (SHMI). The growth for the next year was given in the survey as 5.31 percent at national level. The subsequent study by the Quaidian Economic Consultants Quaid-i-Azam University, Islamabad in 1999-00 estimated the growth rates of 6.86 percent and 7.51 percent for the years 1998-99 and 1999-00 respectively. Due to unavailability of such surveys at provincial levels, the current analysis of SSM is based on estimating employed labor force shares of each province to the national employed labor force. The slaughtering is estimated using provincial shares of monthly expenditures on milk, all kind of meat and eggs. The data on percentage distribution of consumption of these products has been obtained from HIES of various year.⁵⁰

⁴⁸ PBS authorities on demand provided the data.

⁴⁹ The Provincial Bureau of Statistics bases the QIM on monthly surveys of industrial production and employment uniformly in all provinces.

⁵⁰ The Pakistan Bureau of Statistics has calculated a growth rate of 5.31 percent based on small household manufacturing index (SHMI) at national level, until 1997-98. For 1998-99 and 1999-00 the growth rates recommended by Quaid-i-Azam University was 6.86 percent and 7.51 percent respectively.

Construction: Ideally, the construction subsector value added should be calculated through the expenditure approach, as is done by PBS at the national level. However, since the provincial expenditure data on construction was not available, the provincial share of construction workers was used instead to derive estimates for 1999-00 to 2010-11. The construction worker's data was missing for some years which were then interpolated to get the full series. The data on percentage distribution of employment in construction industry in Pakistan and the provinces were obtained from PBS's Labor Force Surveys of various years.

Annex Table 1.3 KP Manufacturing and Mining Sector Profile (1999-00 to 2010-11)

| | Large Scale Manuf. | | Small Scale Manuf. | | Slaughtering | | Mining | |
|---------|----------------------|-----------------------|----------------------|-----------------------|----------------------|-----------------------|----------------------|-----------------------|
| | Value added (Mil Rs) | Share of National (%) | Value added (Mil Rs) | Share of National (%) | Value added (Mil Rs) | Share of National (%) | Value added (Mil Rs) | Share of National (%) |
| 1999/00 | 27,779 | 8.2 | 14,542 | 11.0 | 12,538 | 24.2 | 1031 | 1.3 |
| 2000/01 | 27,275 | 7.3 | 15,550 | 10.9 | 12,908 | 24.2 | 28807 | 33.7 |
| 2001/02 | 28,372 | 7.3 | 16,613 | 10.9 | 13,891 | 25.3 | 1288 | 1.4 |
| 2002/03 | 30,514 | 7.3 | 17,618 | 10.7 | 14,299 | 25.3 | 1808 | 1.9 |
| 2003/04 | 36,077 | 7.3 | 18,695 | 10.6 | 14,644 | 25.3 | 1819 | 1.6 |
| 2004/05 | 43,179 | 7.3 | 20,099 | 10.6 | 13,366 | 22.5 | 2416 | 2.0 |
| 2005/06 | 46,512 | 7.3 | 22,981 | 11.1 | 17,744 | 26.6 | 4584 | 3.6 |
| 2006/07 | 50,578 | 7.3 | 23,813 | 10.7 | 18,472 | 26.6 | 7711 | 5.8 |
| 2007/08 | 52,624 | 7.3 | 28,030 | 11.7 | 19,170 | 26.5 | 9153 | 6.6 |
| 2008/09 | 48,381 | 7.3 | 30,346 | 11.8 | 19,979 | 26.5 | 8614 | 6.3 |
| 2009/10 | 50,765 | 7.3 | 30,620 | 11.0 | 20,844 | 26.5 | 13540 | 9.6 |
| 2009/11 | 51,265 | 7.3 | 33,532 | 11.2 | 19,012 | 23.2 | 19521 | 13.8 |

Source: National Accounts data and WB staff calculations

Annex Table 1.4 KP Gross Value Added of Selected Sector at Constant Factor Cost (Rs million)

| | Construction | Elec. & Gas Distrib. | Trans. & Comm | Fin. & Insr. |
|---------|--------------|----------------------|---------------|--------------|
| 1999/00 | 14,612 | 29,190 | 65,895 | 14,689 |
| 2000/01 | 13,867 | 22,882 | 72,934 | 12,378 |
| 2001/02 | 13,344 | 21,246 | 77,545 | 14,356 |
| 2002/03 | 15,215 | 19,297 | 80,324 | 14,203 |
| 2003/04 | 13,923 | 30,236 | 82,602 | 15,497 |
| 2004/05 | 16,507 | 27,356 | 85,501 | 20,190 |
| 2005/06 | 20,070 | 19,357 | 86,107 | 43,581 |
| 2006/07 | 22,774 | 19,670 | 84,779 | 49,034 |
| 2007/08 | 19,714 | 14,344 | 82,414 | 53,338 |
| 2008/09 | 17,578 | 22,092 | 83,644 | 44,071 |
| 2009/10 | 21,200 | 25,604 | 84,165 | 34,456 |
| 2009/11 | 23,355 | 22,933 | 83,427 | 27,942 |

Source: National Accounts data and WB staff calculations

Annex Table 1.5 KP Gross Value Added of Selected Sector Share of National GDP (at Constant Factor Cost,%)

| | Construction | Elec & Gas Distrib | Trans. & Comm | Fin & Insr |
|---------|--------------|--------------------|---------------|------------|
| 1999/00 | 16.72 | 9.2 | 16.4 | 11.1 |
| 2000/01 | 15.79 | 11.6 | 17.3 | 11.0 |
| 2001/02 | 14.95 | 9.0 | 18.1 | 10.9 |
| 2002/03 | 16.40 | 8.1 | 18.0 | 10.9 |
| 2003/04 | 16.81 | 7.6 | 17.9 | 10.9 |
| 2004/05 | 16.81 | 8.2 | 17.9 | 10.9 |
| 2005/06 | 18.55 | 8.6 | 17.4 | 16.4 |
| 2006/07 | 16.93 | 10.3 | 16.3 | 16.1 |
| 2007/08 | 15.51 | 10.4 | 15.3 | 15.8 |
| 2008/09 | 15.57 | 11.6 | 15.0 | 14.1 |
| 2009/10 | 14.62 | 11.8 | 14.7 | 12.4 |
| 2009/11 | 15.98 | 11.9 | 14.3 | 10.7 |

Source: National Accounts data and WB staff calculations

Electricity and Gas: In the Electricity and Gas subsector, value added was estimated on the basis of electricity generation, electricity consumption and natural gas consumption. The data were taken from various Energy Year Books (1999-00 to 2010-11) published annually by the Hydrocarbon Development Institute of Pakistan. Data were obtained for electricity generation for hydel and thermal electricity; these figures were multiplied with a single year (i.e. constant) price to get constant rupee value of electricity generation. The value of electricity consumption was then taken a proxy for value of electricity transmission and distribution. Similarly, the value of gas consumption was taken as a proxy for the value of gas distribution. These three constant (i.e. at a single year price) values of the three components were then added for both Pakistan and the provinces to get constant value generated in the subsector at the national and provincial level. Finally, the provincial value added in electricity and gas was derived by applying to the national value added estimate the derived ratio of the provincial value to national value.

To estimate the value added for all other sectors, the income approach has been used. The average household income from each sector and the number of surveyed household were used to get an estimate of total sample income derived from each sector in each province. The HIES uses a stratified random sampling methodology. However, in order to get more robust estimates, the survey oversamples the two smaller provinces (KP and Balochistan) and under-samples Punjab and Sindh. As such, the total household income derived from HIES needs to be adjusted by 'raising' factors to make sample estimates in line with national population shares.

To make these estimates more meaningful, two additional factors have to be kept in mind. First, the HIES distinguishes between 'earned' and 'unearned' income. While the former includes income that a household receives as an employee, employee through self employment; whereas the latter includes income from housing (i.e. rent) and as transfer payments. Rents, both actual and imputed, is income from 'ownership of dwellings' and is a part of Pakistan's national accounts classification. Transfer payments could be discarded for calculation of provincial GDP because if these payments originate from outside the province (i.e. from other provinces or abroad) they can be considered as 'factor income from abroad', which is part of GNP and not GDP. If these payments originate from within the province, it would imply 'double counting' of income, as the source of these payments is already accounted in earned or rental income.

Second, as some of the earned income could be originating from outside the province (i.e. from other provinces), there is a need to make necessary adjustments. It is assumed that earned income originating outside the province is likely to be small on the net basis and therefore could be ignored for the purpose of calculating provincial GDP.⁵¹

The adjusted total household income (derived from each sector) for each province, and for the country, were used to derive provincial shares in each income generating sector. These shares are then applied to the national value added in each sector to get the valued-added estimates for each province, which total up to an estimate of provincial GDP.

⁵¹ It is assumed, for example, that earned income originating outside Sindh but reported by Sindhi households would be more or less counterbalanced by earned income originating in Sindh but reported by household in other provinces.

Table 1: Gross Provincial Value Added at constant factor cost @ 1999/00

| At 1999/00 Million Rupees | | | | | | | | | | | | | |
|---------------------------|---------------------------------|----------------------|---------------|-------------------------|--------------|------------------------------|-----------------------|---------------------------|----------------------------------|------------------------|------------------|-----------------------|-------------------------------|
| Pakistan | Agriculture, Fishing & Forestry | Mining and Quarrying | Manufacturing | Electricity, Gas, Water | Construction | Whole Sale and related trade | Transport and Storage | Finance, Real Estate etc. | Community, Social, Personal Srv. | Ownership of Dwellings | TOTAL | Growth rate Total GDP | Share of Pakistan's Total GDP |
| 1999/00 | 923,609 | 81,052 | 522,801 | 139,624 | 87,386 | 620,591 | 400,983 | 132,454 | 541,842 | 110,425 | 3,560,768 | | 100.0 |
| 2000/01 | 903,499 | 85,528 | 571,357 | 120,464 | 87,846 | 648,532 | 422,195 | 112,455 | 564,589 | 114,593 | 3,631,057 | 2.0% | 100.0 |
| 2001/02 | 904,433 | 90,431 | 596,841 | 112,026 | 89,241 | 667,662 | 427,296 | 131,761 | 606,870 | 118,604 | 3,745,165 | 3.1% | 100.0 |
| 2002/03 | 941,942 | 96,418 | 638,044 | 98,932 | 92,789 | 709,031 | 445,552 | 130,081 | 648,215 | 122,466 | 3,923,470 | 4.8% | 100.0 |
| 2003/04 | 964,853 | 111,473 | 727,439 | 155,078 | 82,818 | 770,366 | 461,276 | 141,768 | 677,446 | 126,764 | 4,219,281 | 7.5% | 100.0 |
| 2004/05 | 1,027,403 | 122,621 | 840,243 | 146,214 | 98,190 | 866,143 | 477,171 | 185,501 | 705,978 | 131,214 | 4,600,679 | 9.0% | 100.0 |
| 2005/06 | 1,092,098 | 128,288 | 912,953 | 107,391 | 108,195 | 905,382 | 496,073 | 265,056 | 776,176 | 135,820 | 4,927,432 | 7.1% | 100.0 |
| 2006/07 | 1,137,037 | 132,254 | 988,301 | 111,944 | 134,536 | 949,072 | 519,486 | 304,514 | 835,259 | 140,587 | 5,252,990 | 6.6% | 100.0 |
| 2007/08 | 1,148,851 | 138,047 | 1,036,101 | 85,893 | 127,076 | 991,893 | 539,297 | 338,386 | 889,609 | 145,521 | 5,440,674 | 3.6% | 100.0 |
| 2008/09 | 1,195,002 | 137,348 | 998,846 | 136,591 | 112,884 | 978,254 | 558,703 | 312,818 | 951,520 | 150,629 | 5,532,595 | 1.7% | 100.0 |
| 2009/10 | 1,201,944 | 140,378 | 1,054,276 | 160,706 | 144,985 | 1,023,513 | 574,101 | 277,555 | 1,008,301 | 155,916 | 5,741,675 | 3.8% | 100.0 |
| 2010/11 | 1,216,523 | 140,971 | 1,085,440 | 126,780 | 146,169 | 1,061,887 | 581,388 | 260,172 | 1,100,779 | 158,707 | 5,878,816 | 2.4% | 100.0 |
| PUNJAB | | | | | | | | | | | | | |
| 1999/00 | 537,660 | 12,368 | 240,191 | 55,142 | 54,287 | 347,593 | 210,032 | 66,351 | 268,172 | 49,079 | 1,840,875 | | 51.7 |
| 2000/01 | 522,478 | 12,788 | 259,948 | 52,067 | 54,321 | 359,777 | 220,905 | 56,893 | 279,515 | 50,932 | 1,869,624 | 1.6% | 51.5 |
| 2001/02 | 519,228 | 13,530 | 274,638 | 48,063 | 54,956 | 369,231 | 223,193 | 67,142 | 300,683 | 52,714 | 1,923,379 | 2.9% | 51.4 |
| 2002/03 | 533,312 | 13,691 | 297,359 | 42,681 | 56,317 | 388,790 | 231,440 | 65,795 | 324,120 | 54,431 | 2,007,935 | 4.4% | 51.2 |
| 2003/04 | 538,312 | 13,933 | 341,805 | 66,664 | 49,679 | 416,031 | 238,261 | 71,105 | 340,879 | 56,341 | 2,133,010 | 6.2% | 50.6 |
| 2004/05 | 603,765 | 14,403 | 399,296 | 64,829 | 58,900 | 478,405 | 246,889 | 91,754 | 356,467 | 58,319 | 2,373,028 | 11.3% | 51.6 |
| 2005/06 | 637,797 | 16,151 | 436,053 | 48,877 | 60,311 | 551,256 | 270,891 | 143,335 | 409,361 | 72,793 | 2,646,826 | 11.5% | 53.7 |
| 2006/07 | 665,281 | 15,563 | 473,627 | 52,441 | 79,547 | 585,197 | 280,562 | 156,709 | 437,430 | 77,675 | 2,824,032 | 6.7% | 53.8 |
| 2007/08 | 659,193 | 16,179 | 492,411 | 40,166 | 78,887 | 619,729 | 288,028 | 165,291 | 462,600 | 82,811 | 2,905,296 | 2.9% | 53.4 |
| 2008/09 | 686,233 | 15,622 | 477,074 | 63,269 | 70,072 | 612,848 | 300,474 | 163,974 | 498,706 | 85,244 | 2,973,517 | 2.3% | 53.7 |
| 2009/10 | 688,375 | 15,424 | 507,378 | 73,818 | 91,550 | 643,352 | 310,895 | 155,403 | 532,610 | 87,745 | 3,106,550 | 4.5% | 54.1 |
| 2010/11 | 700,536 | 15,593 | 523,242 | 54,647 | 94,602 | 670,353 | 317,007 | 154,963 | 585,985 | 88,817 | 3,205,744 | 3.2% | 54.5 |
| SINDH | | | | | | | | | | | | | |
| 1999/00 | 205,784 | 39,903 | 204,982 | 42,460 | 14,056 | 174,243 | 96,807 | 49,655 | 141,478 | 40,905 | 1,010,275 | | 28.4 |
| 2000/01 | 195,557 | 42,575 | 230,397 | 31,570 | 14,855 | 182,903 | 99,145 | 41,057 | 145,693 | 42,449 | 1,026,202 | 1.6% | 28.3 |
| 2001/02 | 185,809 | 47,878 | 232,549 | 32,676 | 15,748 | 183,793 | 97,541 | 46,723 | 154,917 | 43,935 | 1,041,568 | 1.5% | 27.8 |
| 2002/03 | 188,013 | 54,155 | 243,011 | 28,926 | 16,230 | 192,592 | 102,919 | 47,182 | 169,610 | 45,365 | 1,088,003 | 4.5% | 27.7 |
| 2003/04 | 205,051 | 69,572 | 273,528 | 46,391 | 14,888 | 219,337 | 107,810 | 52,545 | 179,817 | 46,957 | 1,215,895 | 11.8% | 28.8 |
| 2004/05 | 207,677 | 80,560 | 311,002 | 42,112 | 17,651 | 245,577 | 110,160 | 70,703 | 191,286 | 48,606 | 1,325,334 | 9.0% | 28.8 |
| 2005/06 | 230,896 | 82,722 | 326,149 | 29,891 | 23,963 | 218,579 | 118,430 | 72,015 | 203,148 | 41,430 | 1,347,224 | 1.7% | 27.3 |
| 2006/07 | 240,593 | 84,769 | 353,826 | 28,269 | 27,271 | 225,207 | 125,243 | 93,065 | 219,616 | 41,077 | 1,438,936 | 6.8% | 27.4 |
| 2007/08 | 252,336 | 88,260 | 371,613 | 22,417 | 23,677 | 229,279 | 131,289 | 114,894 | 234,977 | 40,648 | 1,509,389 | 4.9% | 27.7 |
| 2008/09 | 262,654 | 89,597 | 353,305 | 35,358 | 21,089 | 222,277 | 135,431 | 100,306 | 251,347 | 42,053 | 1,513,416 | 0.3% | 27.4 |
| 2009/10 | 262,993 | 89,242 | 371,773 | 42,345 | 27,127 | 229,099 | 138,565 | 83,758 | 266,364 | 43,507 | 1,554,775 | 2.7% | 27.1 |
| 2010/11 | 263,774 | 84,177 | 382,898 | 34,146 | 23,751 | 234,527 | 139,718 | 73,599 | 290,815 | 44,264 | 1,571,668 | 1.1% | 26.7 |
| K.P. | | | | | | | | | | | | | |
| 1999/00 | 75,759 | 1,031 | 54,859 | 29,190 | 14,612 | 51,050 | 65,895 | 14,689 | 83,615 | 14,902 | 405,601 | | 11.4 |
| 2000/01 | 73,154 | 1,359 | 55,733 | 22,882 | 13,867 | 52,849 | 72,934 | 12,378 | 89,043 | 15,464 | 409,663 | 1.0% | 11.3 |
| 2001/02 | 78,363 | 1,288 | 58,876 | 21,246 | 13,344 | 56,202 | 77,545 | 14,356 | 97,967 | 16,006 | 435,194 | 6.2% | 11.6 |
| 2002/03 | 76,215 | 1,808 | 62,431 | 19,297 | 15,215 | 56,770 | 80,324 | 14,203 | 99,803 | 16,527 | 442,592 | 1.7% | 11.3 |
| 2003/04 | 65,731 | 1,819 | 69,416 | 30,236 | 13,923 | 55,222 | 82,602 | 15,497 | 99,372 | 17,107 | 450,924 | 1.9% | 10.7 |
| 2004/05 | 76,988 | 2,416 | 76,643 | 27,356 | 16,507 | 64,381 | 85,501 | 20,190 | 98,349 | 17,707 | 486,040 | 7.8% | 10.6 |
| 2005/06 | 86,761 | 4,584 | 87,238 | 19,357 | 20,070 | 61,522 | 86,107 | 43,581 | 121,718 | 18,161 | 549,099 | 13.0% | 11.1 |
| 2006/07 | 88,125 | 7,711 | 92,863 | 19,670 | 22,774 | 60,619 | 84,779 | 49,034 | 130,889 | 17,953 | 574,418 | 4.6% | 10.9 |
| 2007/08 | 81,715 | 9,153 | 99,824 | 14,344 | 19,714 | 56,816 | 82,414 | 53,338 | 139,306 | 17,707 | 574,332 | 0.0% | 10.6 |
| 2008/09 | 85,506 | 8,614 | 98,707 | 22,092 | 17,578 | 58,035 | 83,644 | 44,071 | 148,005 | 18,425 | 584,676 | 1.8% | 10.6 |
| 2009/10 | 87,234 | 13,540 | 102,229 | 25,604 | 21,200 | 62,499 | 84,165 | 34,456 | 155,781 | 19,172 | 605,878 | 3.6% | 10.6 |
| 2010/11 | 92,186 | 19,521 | 103,809 | 22,933 | 23,355 | 68,111 | 83,427 | 27,942 | 168,915 | 19,616 | 629,815 | 4.0% | 10.7 |
| BALUCHISTAN | | | | | | | | | | | | | |
| 1999/00 | 104,406 | 27,750 | 22,770 | 12,832 | 4,431 | 47,705 | 28,249 | 1,759 | 48,576 | 5,539 | 304,016 | | 8.5 |
| 2000/01 | 112,311 | 28,807 | 25,278 | 13,944 | 4,802 | 53,002 | 29,211 | 2,127 | 50,337 | 5,748 | 325,568 | 7.1% | 9.0 |
| 2001/02 | 121,032 | 27,735 | 30,777 | 10,041 | 5,194 | 58,436 | 29,017 | 3,540 | 53,303 | 5,949 | 345,023 | 6.0% | 9.2 |
| 2002/03 | 144,402 | 26,765 | 35,243 | 8,028 | 5,027 | 70,879 | 30,869 | 2,901 | 54,682 | 6,143 | 384,940 | 11.6% | 9.8 |
| 2003/04 | 155,760 | 26,149 | 42,690 | 11,788 | 4,328 | 79,776 | 32,603 | 2,622 | 57,378 | 6,359 | 419,452 | 9.0% | 9.9 |
| 2004/05 | 138,973 | 25,242 | 53,301 | 11,917 | 5,132 | 77,781 | 34,621 | 2,854 | 59,875 | 6,582 | 416,276 | -0.8% | 9.0 |
| 2005/06 | 136,644 | 24,830 | 63,513 | 9,265 | 3,850 | 74,025 | 20,645 | 6,125 | 41,949 | 3,436 | 384,282 | -7.7% | 7.8 |
| 2006/07 | 143,038 | 24,210 | 67,985 | 11,564 | 4,943 | 78,049 | 28,902 | 5,706 | 47,323 | 3,882 | 415,604 | 8.2% | 7.9 |
| 2007/08 | 155,608 | 24,455 | 72,253 | 8,965 | 4,798 | 86,069 | 37,566 | 4,863 | 52,726 | 4,355 | 451,658 | 8.7% | 8.3 |
| 2008/09 | 160,609 | 23,515 | 69,760 | 15,872 | 4,145 | 85,094 | 39,154 | 4,467 | 53,463 | 4,907 | 460,986 | 2.1% | 8.3 |
| 2009/10 | 163,342 | 22,172 | 72,896 | 18,939 | 5,108 | 88,563 | 40,476 | 3,938 | 53,546 | 5,492 | 474,472 | 2.9% | 8.3 |
| 2010/11 | 160,028 | 21,680 | 75,491 | 15,054 | 4,462 | 88,896 | 41,236 | 3,668 | 55,064 | 6,010 | 471,588 | -0.6% | 8.0 |

Table 2: Gross Provincial Value Added at current Prices

| At current Million Rupees | | | | | | | | | | | | | |
|---------------------------|---------------------------------|----------------------|---------------|-------------------------|--------------|------------------------------|-----------------------|---------------------------|----------------------------------|------------------------|------------|-----------------------|-------------------------------|
| Pakistan | Agriculture, Fishing & Forestry | Mining and Quarrying | Manufacturing | Electricity, Gas, Water | Construction | Whole Sale and related trade | Transport and Storage | Finance, Real Estate etc. | Community, Social, Personal Srv. | Ownership of Dwellings | TOTAL | Growth rate Total GDP | Share of Pakistan's Total GDP |
| 1999/00 | 923,609 | 81,052 | 522,801 | 139,624 | 87,386 | 620,591 | 400,983 | 132,454 | 541,842 | 110,425 | 3,560,768 | | 100.0 |
| 2000/01 | 945,301 | 106,370 | 608,132 | 133,089 | 94,670 | 690,755 | 512,997 | 116,997 | 589,473 | 124,359 | 3,922,143 | 10.1% | 100.0 |
| 2001/02 | 968,291 | 116,952 | 642,850 | 134,350 | 95,197 | 720,862 | 542,828 | 142,424 | 656,009 | 126,454 | 4,146,217 | 5.7% | 100.0 |
| 2002/03 | 1,059,316 | 137,044 | 725,434 | 120,556 | 100,880 | 787,293 | 609,929 | 144,989 | 715,155 | 135,139 | 4,535,735 | 9.4% | 100.0 |
| 2003/04 | 1,164,751 | 208,290 | 902,486 | 190,713 | 115,497 | 900,651 | 675,623 | 165,230 | 785,316 | 146,264 | 5,254,821 | 15.9% | 100.0 |
| 2004/05 | 1,314,234 | 182,051 | 1,136,634 | 187,267 | 153,333 | 1,102,596 | 759,711 | 236,254 | 894,529 | 165,441 | 6,132,050 | 16.7% | 100.0 |
| 2005/06 | 1,457,222 | 219,682 | 1,370,793 | 153,338 | 179,885 | 1,362,783 | 908,409 | 364,320 | 1,058,065 | 184,812 | 7,259,310 | 18.4% | 100.0 |
| 2006/07 | 1,685,240 | 252,541 | 1,567,313 | 168,770 | 225,239 | 1,542,170 | 1,012,206 | 447,270 | 1,227,819 | 206,166 | 8,334,734 | 14.8% | 100.0 |
| 2007/08 | 2,017,181 | 301,469 | 1,950,522 | 145,874 | 260,340 | 1,942,892 | 1,155,873 | 556,679 | 1,464,692 | 239,010 | 10,034,532 | 20.4% | 100.0 |
| 2008/09 | 2,611,526 | 346,412 | 2,069,482 | 284,091 | 294,990 | 2,234,243 | 1,587,934 | 621,508 | 1,891,393 | 298,789 | 12,240,368 | 22.0% | 100.0 |
| 2009/10 | 2,978,950 | 371,233 | 2,487,069 | 366,827 | 352,530 | 2,618,196 | 1,846,735 | 616,116 | 2,237,158 | 345,555 | 14,220,369 | 16.2% | 100.0 |
| 2010/11 | 3,698,658 | 431,907 | 3,167,947 | 326,426 | 396,777 | 3,307,163 | 2,132,844 | 649,701 | 2,785,634 | 401,687 | 17,298,744 | 21.6% | 100.0 |
| PUNJAB | | | | | | | | | | | | | |
| 1999/00 | 537,660 | 12,368 | 240,191 | 55,142 | 54,287 | 347,593 | 210,032 | 66,351 | 268,172 | 49,079 | 1,840,875 | | 51.7 |
| 2000/01 | 547,171 | 15,904 | 275,509 | 57,524 | 58,541 | 383,200 | 268,416 | 59,191 | 291,833 | 55,272 | 2,012,561 | 9.3% | 51.3 |
| 2001/02 | 554,585 | 17,498 | 295,644 | 57,641 | 58,624 | 398,652 | 283,540 | 72,576 | 325,029 | 56,203 | 2,119,992 | 5.3% | 51.1 |
| 2002/03 | 601,781 | 19,460 | 361,917 | 52,010 | 61,227 | 431,704 | 316,825 | 73,336 | 357,590 | 60,063 | 2,335,912 | 10.2% | 51.5 |
| 2003/04 | 652,908 | 26,034 | 450,110 | 81,983 | 69,282 | 486,391 | 348,977 | 82,872 | 395,238 | 65,008 | 2,658,802 | 13.8% | 50.6 |
| 2004/05 | 772,922 | 21,384 | 530,393 | 83,032 | 91,978 | 609,007 | 393,076 | 116,857 | 451,731 | 73,531 | 3,143,912 | 18.2% | 51.3 |
| 2005/06 | 840,556 | 27,658 | 641,154 | 69,789 | 100,274 | 829,752 | 496,056 | 197,014 | 558,032 | 99,050 | 3,859,335 | 22.8% | 53.2 |
| 2006/07 | 970,322 | 29,718 | 734,552 | 79,062 | 133,178 | 950,901 | 546,668 | 230,174 | 643,016 | 113,908 | 4,431,498 | 14.8% | 53.2 |
| 2007/08 | 1,154,764 | 35,332 | 909,086 | 68,215 | 161,616 | 1,213,907 | 617,329 | 271,920 | 761,646 | 136,013 | 5,329,827 | 20.3% | 53.1 |
| 2008/09 | 1,515,235 | 39,402 | 967,080 | 131,591 | 183,114 | 1,399,690 | 854,001 | 325,785 | 991,307 | 169,091 | 6,576,295 | 23.4% | 53.7 |
| 2009/10 | 1,726,950 | 40,790 | 1,159,799 | 168,497 | 222,603 | 1,645,725 | 1,000,068 | 344,964 | 1,181,724 | 194,469 | 7,685,589 | 16.9% | 54.0 |
| 2010/11 | 2,191,140 | 47,772 | 1,468,742 | 140,702 | 256,797 | 2,087,761 | 1,162,954 | 386,973 | 1,482,894 | 224,794 | 9,450,530 | 23.0% | 54.6 |
| SINDH | | | | | | | | | | | | | |
| 1999/00 | 205,784 | 39,903 | 204,982 | 42,460 | 14,056 | 174,243 | 96,807 | 49,655 | 141,478 | 40,905 | 1,010,275 | | 28.4 |
| 2000/01 | 205,118 | 52,950 | 247,935 | 34,879 | 16,009 | 194,811 | 120,468 | 42,715 | 152,114 | 46,066 | 1,113,066 | 10.2% | 28.4 |
| 2001/02 | 200,515 | 61,920 | 251,696 | 39,187 | 16,799 | 198,438 | 123,914 | 50,504 | 167,460 | 46,843 | 1,157,275 | 4.0% | 27.9 |
| 2002/03 | 211,675 | 76,973 | 276,081 | 35,249 | 17,645 | 213,850 | 140,889 | 52,589 | 187,123 | 50,060 | 1,262,133 | 9.1% | 27.8 |
| 2003/04 | 246,013 | 129,997 | 339,753 | 57,051 | 20,762 | 256,431 | 157,908 | 61,240 | 208,436 | 54,181 | 1,531,772 | 21.4% | 29.1 |
| 2004/05 | 265,177 | 119,604 | 424,339 | 53,936 | 27,564 | 312,618 | 175,387 | 90,048 | 242,314 | 61,285 | 1,772,271 | 15.7% | 28.9 |
| 2005/06 | 312,400 | 141,654 | 497,525 | 42,680 | 39,842 | 329,006 | 216,870 | 98,985 | 276,927 | 56,374 | 2,012,263 | 13.5% | 27.7 |
| 2006/07 | 363,951 | 161,868 | 569,647 | 42,619 | 45,657 | 365,944 | 244,033 | 136,693 | 322,833 | 60,238 | 2,313,484 | 15.0% | 27.8 |
| 2007/08 | 447,940 | 192,744 | 715,932 | 38,072 | 48,507 | 449,105 | 281,391 | 189,012 | 386,876 | 66,761 | 2,816,340 | 21.7% | 28.1 |
| 2008/09 | 574,048 | 225,977 | 751,293 | 73,539 | 55,109 | 507,659 | 384,919 | 199,288 | 499,617 | 83,417 | 3,354,867 | 19.1% | 27.4 |
| 2009/10 | 648,971 | 236,002 | 902,377 | 96,658 | 65,960 | 586,047 | 445,728 | 185,925 | 590,993 | 96,425 | 3,855,087 | 14.9% | 27.1 |
| 2010/11 | 791,565 | 257,901 | 1,160,493 | 87,917 | 64,471 | 730,416 | 512,560 | 183,792 | 735,937 | 112,032 | 4,637,084 | 20.3% | 26.8 |
| K.P. | | | | | | | | | | | | | |
| 1999/00 | 75,759 | 1,031 | 54,859 | 29,190 | 14,612 | 51,050 | 65,895 | 14,689 | 83,615 | 14,902 | 405,601 | | 11.4 |
| 2000/01 | 76,291 | 1,690 | 58,518 | 25,281 | 14,945 | 56,290 | 88,619 | 12,878 | 92,969 | 16,782 | 444,263 | 9.5% | 11.3 |
| 2001/02 | 83,509 | 1,666 | 62,912 | 25,480 | 14,234 | 60,681 | 98,512 | 15,517 | 105,901 | 17,065 | 485,476 | 9.3% | 11.7 |
| 2002/03 | 84,793 | 2,569 | 61,369 | 23,515 | 16,542 | 63,036 | 109,958 | 15,831 | 110,112 | 18,237 | 505,961 | 4.2% | 11.2 |
| 2003/04 | 78,807 | 3,398 | 75,206 | 37,184 | 19,417 | 64,562 | 120,986 | 18,062 | 115,160 | 19,738 | 552,519 | 9.2% | 10.5 |
| 2004/05 | 98,981 | 3,588 | 105,502 | 35,037 | 25,777 | 81,957 | 136,128 | 25,714 | 124,620 | 22,326 | 659,629 | 19.4% | 10.8 |
| 2005/06 | 119,060 | 7,850 | 132,687 | 27,639 | 33,369 | 92,603 | 157,679 | 59,903 | 165,923 | 24,712 | 821,423 | 24.5% | 11.3 |
| 2006/07 | 134,532 | 14,725 | 150,097 | 29,655 | 38,129 | 98,501 | 165,189 | 72,021 | 192,405 | 26,327 | 921,582 | 12.2% | 11.1 |
| 2007/08 | 145,097 | 19,989 | 185,162 | 24,361 | 40,388 | 111,290 | 176,638 | 87,746 | 229,360 | 29,082 | 1,049,114 | 13.8% | 10.5 |
| 2008/09 | 187,302 | 21,726 | 201,200 | 45,949 | 45,935 | 132,546 | 237,731 | 87,560 | 294,197 | 36,548 | 1,290,693 | 23.0% | 10.5 |
| 2009/10 | 216,107 | 35,806 | 241,565 | 58,443 | 51,547 | 159,875 | 270,738 | 76,485 | 345,637 | 42,490 | 1,498,692 | 16.1% | 10.5 |
| 2010/11 | 272,058 | 59,809 | 300,206 | 59,046 | 63,396 | 212,127 | 306,055 | 69,777 | 427,458 | 49,649 | 1,819,582 | 21.4% | 10.5 |
| BALUCHISTAN | | | | | | | | | | | | | |
| 1999/00 | 104,406 | 27,750 | 22,770 | 12,832 | 4,431 | 47,705 | 28,249 | 1,759 | 48,576 | 5,539 | 304,016 | | 8.5 |
| 2000/01 | 116,722 | 35,827 | 26,170 | 15,405 | 5,175 | 56,453 | 35,493 | 2,213 | 52,557 | 6,238 | 352,253 | 15.9% | 9.0 |
| 2001/02 | 129,682 | 35,869 | 32,599 | 12,041 | 5,540 | 63,092 | 36,862 | 3,826 | 57,619 | 6,343 | 383,474 | 8.9% | 9.2 |
| 2002/03 | 161,068 | 38,042 | 26,067 | 9,783 | 5,466 | 78,703 | 42,257 | 3,233 | 60,330 | 6,779 | 431,729 | 12.6% | 9.5 |
| 2003/04 | 187,024 | 48,861 | 37,417 | 14,496 | 6,036 | 93,267 | 47,753 | 3,055 | 66,481 | 7,337 | 511,728 | 18.5% | 9.7 |
| 2004/05 | 177,154 | 37,476 | 76,400 | 15,263 | 8,013 | 99,014 | 55,121 | 3,634 | 75,864 | 8,299 | 556,238 | 8.7% | 9.1 |
| 2005/06 | 185,206 | 42,520 | 99,428 | 13,230 | 6,401 | 111,423 | 57,804 | 8,418 | 57,184 | 4,676 | 566,289 | 1.8% | 7.8 |
| 2006/07 | 216,435 | 46,230 | 113,016 | 17,434 | 8,276 | 126,823 | 56,316 | 8,382 | 69,565 | 5,693 | 668,170 | 18.0% | 8.0 |
| 2007/08 | 269,380 | 53,404 | 140,342 | 15,226 | 9,829 | 168,590 | 80,515 | 8,001 | 86,810 | 7,153 | 839,250 | 25.6% | 8.4 |
| 2008/09 | 334,941 | 59,308 | 149,909 | 33,012 | 10,832 | 194,348 | 111,283 | 8,876 | 106,271 | 9,733 | 1,018,512 | 21.4% | 8.3 |
| 2009/10 | 386,922 | 58,635 | 183,328 | 43,229 | 12,420 | 226,550 | 130,201 | 8,742 | 118,804 | 12,171 | 1,181,001 | 16.0% | 8.3 |
| 2010/11 | 443,895 | 66,424 | 238,506 | 38,761 | 12,113 | 276,858 | 151,275 | 9,159 | 139,345 | 15,211 | 1,391,547 | 17.8% | 8.0 |

| Table 3: Annual Growth in Gross Provincial Value Added at constant factor cost | | | | | | | | | | | |
|---|--|-----------------------------|----------------------|--------------------------------|---------------------|-------------------------------------|------------------------------|----------------------------------|---|-------------------------------|--------------|
| <i>Annual percentage growth</i> | | | | | | | | | | | |
| Pakistan | Agriculture, Fishing & Forestry | Mining and Quarrying | Manufacturing | Electricity, Gas, Water | Construction | Whole Sale and related trade | Transport and Storage | Finance, Real Estate etc. | Community, Social, Personal Srv. | Ownership of Dwellings | TOTAL |
| 1999/00 | | | | | | | | | | | |
| 2000/01 | -2.18 | 5.52 | 9.29 | -13.72 | 0.53 | 4.50 | 5.29 | -15.10 | 4.20 | 3.77 | 1.97 |
| 2001/02 | 0.10 | 5.73 | 4.46 | -7.00 | 1.59 | 2.95 | 1.21 | 17.17 | 7.49 | 3.50 | 3.14 |
| 2002/03 | 4.15 | 6.62 | 6.90 | -11.69 | 3.98 | 6.20 | 4.27 | -1.28 | 6.81 | 3.26 | 4.76 |
| 2003/04 | 2.43 | 15.61 | 14.01 | 56.75 | -10.75 | 8.65 | 3.53 | 8.98 | 4.51 | 3.51 | 7.54 |
| 2004/05 | 6.48 | 10.00 | 15.51 | -5.72 | 18.56 | 12.43 | 3.45 | 30.85 | 4.21 | 3.51 | 9.04 |
| 2005/06 | 6.30 | 4.62 | 8.65 | -26.55 | 10.19 | 4.53 | 3.96 | 42.89 | 9.94 | 3.51 | 7.10 |
| 2006/07 | 4.11 | 3.09 | 8.25 | 4.24 | 24.35 | 4.83 | 4.72 | 14.89 | 7.61 | 3.51 | 6.61 |
| 2007/08 | 1.04 | 4.38 | 4.84 | -23.27 | -5.54 | 4.51 | 3.81 | 11.12 | 6.51 | 3.51 | 3.57 |
| 2008/09 | 4.02 | -0.51 | -3.60 | 59.02 | -11.17 | -1.38 | 3.60 | -7.56 | 6.96 | 3.51 | 1.69 |
| 2009/10 | 0.58 | 2.21 | 5.55 | 17.65 | 28.44 | 4.63 | 2.76 | -11.27 | 5.97 | 3.51 | 3.78 |
| 2010/11 | 1.21 | 0.42 | 2.96 | -21.11 | 0.82 | 3.75 | 1.27 | -6.26 | 9.17 | 1.79 | 2.39 |
| PUNJAB | | | | | | | | | | | |
| 1999/00 | | | | | | | | | | | |
| 2000/01 | -2.82 | 3.39 | 8.23 | -5.58 | 0.06 | 3.51 | 5.18 | -14.25 | 4.23 | 3.77 | 1.56 |
| 2001/02 | -0.62 | 5.80 | 5.65 | -7.69 | 1.17 | 2.63 | 1.04 | 18.01 | 7.57 | 3.50 | 2.88 |
| 2002/03 | 2.71 | 1.19 | 8.27 | -11.20 | 2.48 | 5.30 | 3.70 | -2.01 | 7.79 | 3.26 | 4.40 |
| 2003/04 | 0.94 | 1.77 | 14.95 | 56.19 | -11.79 | 7.01 | 2.95 | 8.07 | 5.17 | 3.51 | 6.23 |
| 2004/05 | 12.16 | 3.38 | 16.82 | -2.75 | 18.56 | 14.99 | 3.62 | 29.04 | 4.57 | 3.51 | 11.25 |
| 2005/06 | 5.64 | 12.14 | 9.21 | -24.61 | 2.40 | 15.23 | 9.72 | 56.22 | 14.84 | 24.82 | 11.54 |
| 2006/07 | 4.31 | -3.64 | 8.62 | 7.29 | 31.89 | 6.16 | 3.57 | 9.33 | 6.86 | 6.71 | 6.70 |
| 2007/08 | -0.92 | 3.96 | 3.97 | -23.41 | -0.83 | 5.90 | 2.66 | 5.48 | 5.75 | 6.61 | 2.88 |
| 2008/09 | 4.10 | -3.44 | -3.11 | 57.52 | -11.17 | -1.11 | 4.32 | -0.80 | 7.80 | 2.94 | 2.35 |
| 2009/10 | 0.31 | -1.27 | 6.35 | 16.67 | 30.65 | 4.98 | 3.47 | -5.23 | 6.80 | 2.93 | 4.47 |
| 2010/11 | 1.77 | 1.09 | 3.13 | -25.97 | 3.33 | 4.20 | 1.97 | -0.28 | 10.02 | 1.22 | 3.19 |
| SINDH | | | | | | | | | | | |
| 1999/00 | | | | | | | | | | | |
| 2000/01 | -4.97 | 6.69 | 12.40 | -25.65 | 5.68 | 4.97 | 2.41 | -17.32 | 2.98 | 3.77 | 1.58 |
| 2001/02 | -4.98 | 12.46 | 0.93 | 3.50 | 6.01 | 0.49 | -1.62 | 13.80 | 6.33 | 3.50 | 1.50 |
| 2002/03 | 1.19 | 13.11 | 4.50 | -11.47 | 3.06 | 4.79 | 5.51 | 0.98 | 9.48 | 3.26 | 4.46 |
| 2003/04 | 9.06 | 28.47 | 12.56 | 60.37 | -8.27 | 13.89 | 4.75 | 11.37 | 6.02 | 3.51 | 11.75 |
| 2004/05 | 1.28 | 15.79 | 13.70 | -9.22 | 18.56 | 11.96 | 2.18 | 34.56 | 6.38 | 3.51 | 9.00 |
| 2005/06 | 11.18 | 2.68 | 4.87 | -29.02 | 35.76 | -10.99 | 7.51 | 1.86 | 6.20 | -14.76 | 1.65 |
| 2006/07 | 4.20 | 2.47 | 8.49 | -5.43 | 13.80 | 3.03 | 5.75 | 29.23 | 8.11 | -0.85 | 6.81 |
| 2007/08 | 4.88 | 4.12 | 5.03 | -20.70 | -13.18 | 1.81 | 4.83 | 23.46 | 6.99 | -1.04 | 4.90 |
| 2008/09 | 4.09 | 1.51 | -4.93 | 57.72 | -10.93 | -3.05 | 3.15 | -12.70 | 6.97 | 3.46 | 0.27 |
| 2009/10 | 0.13 | -0.40 | 5.23 | 19.76 | 28.64 | 3.07 | 2.31 | -16.50 | 5.97 | 3.46 | 2.73 |
| 2010/11 | 0.30 | -5.68 | 2.99 | -19.36 | -12.45 | 2.37 | 0.83 | -12.13 | 9.18 | 1.74 | 1.09 |
| K.P. | | | | | | | | | | | |
| 1999/00 | | | | | | | | | | | |
| 2000/01 | -3.44 | 31.84 | 1.59 | -21.61 | -5.09 | 3.52 | 10.68 | -15.73 | 6.49 | 3.77 | 1.00 |
| 2001/02 | 7.12 | -5.20 | 5.64 | -7.15 | -3.78 | 6.34 | 6.32 | 15.98 | 10.02 | 3.50 | 6.23 |
| 2002/03 | -2.74 | 40.34 | 6.04 | -9.18 | 14.03 | 1.01 | 3.58 | -1.06 | 1.87 | 3.26 | 1.70 |
| 2003/04 | -13.76 | 0.62 | 11.19 | 56.69 | -8.49 | -2.73 | 2.84 | 9.11 | -0.43 | 3.51 | 1.88 |
| 2004/05 | 17.13 | 32.86 | 10.41 | -9.52 | 18.56 | 16.58 | 3.51 | 30.28 | -1.03 | 3.51 | 7.79 |
| 2005/06 | 12.69 | 89.71 | 13.82 | -29.24 | 21.59 | -4.44 | 0.71 | 115.85 | 23.76 | 2.56 | 12.97 |
| 2006/07 | 1.57 | 68.22 | 6.45 | 1.62 | 13.47 | -1.47 | -1.54 | 12.51 | 7.54 | -1.15 | 4.61 |
| 2007/08 | -7.27 | 18.70 | 7.50 | -27.08 | -13.44 | -6.27 | -2.79 | 8.78 | 6.43 | -1.37 | -0.01 |
| 2008/09 | 4.64 | -5.89 | -1.12 | 54.01 | -10.83 | 2.14 | 1.49 | -17.37 | 6.24 | 4.06 | 1.80 |
| 2009/10 | 2.02 | 57.18 | 3.57 | 15.90 | 20.60 | 7.69 | 0.62 | -21.82 | 5.25 | 4.05 | 3.63 |
| 2010/11 | 5.68 | 44.18 | 1.55 | -10.43 | 10.16 | 8.98 | -0.88 | -18.90 | 8.43 | 2.32 | 3.95 |
| BALUCHISTAN | | | | | | | | | | | |
| 1999/00 | | | | | | | | | | | |
| 2000/01 | 7.57 | 3.81 | 11.02 | 8.67 | 8.38 | 11.10 | 3.41 | 20.93 | 3.63 | 3.77 | 7.09 |
| 2001/02 | 7.77 | -3.72 | 21.75 | -27.99 | 8.16 | 10.25 | -0.67 | 66.44 | 5.89 | 3.50 | 5.98 |
| 2002/03 | 19.31 | -3.50 | 14.51 | -20.04 | -3.20 | 21.29 | 6.38 | -18.05 | 2.59 | 3.26 | 11.57 |
| 2003/04 | 7.87 | -2.30 | 21.13 | 46.83 | -13.91 | 12.55 | 5.62 | -9.63 | 4.93 | 3.51 | 8.97 |
| 2004/05 | -10.78 | -3.47 | 24.86 | 1.10 | 18.56 | -2.50 | 6.19 | 8.85 | 4.35 | 3.51 | -0.76 |
| 2005/06 | -1.68 | -1.63 | 19.16 | -22.25 | -24.97 | -4.83 | -40.37 | 114.62 | -29.94 | -47.80 | -7.69 |
| 2006/07 | 4.68 | -2.50 | 7.04 | 24.80 | 28.40 | 5.44 | 40.00 | -6.83 | 12.81 | 12.98 | 8.15 |
| 2007/08 | 8.79 | 1.01 | 6.28 | -22.47 | -2.95 | 10.28 | 29.98 | -14.77 | 11.42 | 12.19 | 8.68 |
| 2008/09 | 3.21 | -3.84 | -3.45 | 77.04 | -13.60 | -1.13 | 4.23 | -8.14 | 1.40 | 12.66 | 2.07 |
| 2009/10 | 1.70 | -5.71 | 4.50 | 19.32 | 23.23 | 4.08 | 3.38 | -11.84 | 0.15 | 11.92 | 2.93 |
| 2010/11 | -2.03 | -2.22 | 3.56 | -20.51 | -12.64 | 0.37 | 1.88 | -6.87 | 2.84 | 9.44 | -0.61 |

| Table 4: Annual Shares of Gross Provincial Value Added to National Value Added @ current Prices | | | | | | | | | | | |
|--|--|-----------------------------|----------------------|--------------------------------|---------------------|-------------------------------------|------------------------------|----------------------------------|---|-------------------------------|--------------|
| <i>Share of National GDP</i> | | | | | | | | | | | |
| Pakistan | Agriculture, Fishing & Forestry | Mining and Quarrying | Manufacturing | Electricity, Gas, Water | Construction | Whole Sale and related trade | Transport and Storage | Finance, Real Estate etc. | Community, Social, Personal Srv. | Ownership of Dwellings | TOTAL |
| 1999/00 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2000/01 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2001/02 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2002/03 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2003/04 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2004/05 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2005/06 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2006/07 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2007/08 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2008/09 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2009/10 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| 2010/11 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| PUNJAB | | | | | | | | | | | |
| 1999/00 | 58.2 | 15.3 | 45.9 | 39.5 | 62.1 | 56.0 | 52.4 | 50.1 | 49.5 | 44.4 | 51.7 |
| 2000/01 | 57.9 | 15.0 | 45.3 | 43.2 | 61.8 | 55.5 | 52.3 | 50.6 | 49.5 | 44.4 | 51.3 |
| 2001/02 | 57.3 | 15.0 | 46.0 | 42.9 | 61.6 | 55.3 | 52.2 | 51.0 | 49.5 | 44.4 | 51.1 |
| 2002/03 | 56.8 | 14.2 | 49.9 | 43.1 | 60.7 | 54.8 | 51.9 | 50.6 | 50.0 | 44.4 | 51.5 |
| 2003/04 | 56.1 | 12.5 | 49.9 | 43.0 | 60.0 | 54.0 | 51.7 | 50.2 | 50.3 | 44.4 | 50.6 |
| 2004/05 | 58.8 | 11.7 | 46.7 | 44.3 | 60.0 | 55.2 | 51.7 | 49.5 | 50.5 | 44.4 | 51.3 |
| 2005/06 | 57.7 | 12.6 | 46.8 | 45.5 | 55.7 | 60.9 | 54.6 | 54.1 | 52.7 | 53.6 | 53.2 |
| 2006/07 | 57.6 | 11.8 | 46.9 | 46.8 | 59.1 | 61.7 | 54.0 | 51.5 | 52.4 | 55.3 | 53.2 |
| 2007/08 | 57.2 | 11.7 | 46.6 | 46.8 | 62.1 | 62.5 | 53.4 | 48.8 | 52.0 | 56.9 | 53.1 |
| 2008/09 | 58.0 | 11.4 | 46.7 | 46.3 | 62.1 | 62.6 | 53.8 | 52.4 | 52.4 | 56.6 | 53.7 |
| 2009/10 | 58.0 | 11.0 | 46.6 | 45.9 | 63.1 | 62.9 | 54.2 | 56.0 | 52.8 | 56.3 | 54.0 |
| 2010/11 | 59.2 | 11.1 | 46.4 | 43.1 | 64.7 | 63.1 | 54.5 | 59.6 | 53.2 | 56.0 | 54.6 |
| SINDH | | | | | | | | | | | |
| 1999/00 | 22.3 | 49.2 | 39.2 | 30.4 | 16.1 | 28.1 | 24.1 | 37.5 | 26.1 | 37.0 | 28.4 |
| 2000/01 | 21.7 | 49.8 | 40.8 | 26.2 | 16.9 | 28.2 | 23.5 | 36.5 | 25.8 | 37.0 | 28.4 |
| 2001/02 | 20.7 | 52.9 | 39.2 | 29.2 | 17.6 | 27.5 | 22.8 | 35.5 | 25.5 | 37.0 | 27.9 |
| 2002/03 | 20.0 | 56.2 | 38.1 | 29.2 | 17.5 | 27.2 | 23.1 | 36.3 | 26.2 | 37.0 | 27.8 |
| 2003/04 | 21.1 | 62.4 | 37.6 | 29.9 | 18.0 | 28.5 | 23.4 | 37.1 | 26.5 | 37.0 | 29.1 |
| 2004/05 | 20.2 | 65.7 | 37.3 | 28.8 | 18.0 | 28.4 | 23.1 | 38.1 | 27.1 | 37.0 | 28.9 |
| 2005/06 | 21.4 | 64.5 | 36.3 | 27.8 | 22.1 | 24.1 | 23.9 | 27.2 | 26.2 | 30.5 | 27.7 |
| 2006/07 | 21.6 | 64.1 | 36.3 | 25.3 | 20.3 | 23.7 | 24.1 | 30.6 | 26.3 | 29.2 | 27.8 |
| 2007/08 | 22.2 | 63.9 | 36.7 | 26.1 | 18.6 | 23.1 | 24.3 | 34.0 | 26.4 | 27.9 | 28.1 |
| 2008/09 | 22.0 | 65.2 | 36.3 | 25.9 | 18.7 | 22.7 | 24.2 | 32.1 | 26.4 | 27.9 | 27.4 |
| 2009/10 | 21.8 | 63.6 | 36.3 | 26.3 | 18.7 | 22.4 | 24.1 | 30.2 | 26.4 | 27.9 | 27.1 |
| 2010/11 | 21.4 | 59.7 | 36.6 | 26.9 | 16.2 | 22.1 | 24.0 | 28.3 | 26.4 | 27.9 | 26.8 |
| K.P. | | | | | | | | | | | |
| 1999/00 | 8.2 | 1.3 | 10.5 | 20.9 | 16.7 | 8.2 | 16.4 | 11.1 | 15.4 | 13.5 | 11.4 |
| 2000/01 | 8.1 | 1.6 | 9.6 | 19.0 | 15.8 | 8.1 | 17.3 | 11.0 | 15.8 | 13.5 | 11.3 |
| 2001/02 | 8.6 | 1.4 | 9.8 | 19.0 | 15.0 | 8.4 | 18.1 | 10.9 | 16.1 | 13.5 | 11.7 |
| 2002/03 | 8.0 | 1.9 | 8.5 | 19.5 | 16.4 | 8.0 | 18.0 | 10.9 | 15.4 | 13.5 | 11.2 |
| 2003/04 | 6.8 | 1.6 | 8.3 | 19.5 | 16.8 | 7.2 | 17.9 | 10.9 | 14.7 | 13.5 | 10.5 |
| 2004/05 | 7.5 | 2.0 | 9.3 | 18.7 | 16.8 | 7.4 | 17.9 | 10.9 | 13.9 | 13.5 | 10.8 |
| 2005/06 | 8.2 | 3.6 | 9.7 | 18.0 | 18.5 | 6.8 | 17.4 | 16.4 | 15.7 | 13.4 | 11.3 |
| 2006/07 | 8.0 | 5.8 | 9.6 | 17.6 | 16.9 | 6.4 | 16.3 | 16.1 | 15.7 | 12.8 | 11.1 |
| 2007/08 | 7.2 | 6.6 | 9.5 | 16.7 | 15.5 | 5.7 | 15.3 | 15.8 | 15.7 | 12.2 | 10.5 |
| 2008/09 | 7.2 | 6.3 | 9.7 | 16.2 | 15.6 | 5.9 | 15.0 | 14.1 | 15.6 | 12.2 | 10.5 |
| 2009/10 | 7.3 | 9.6 | 9.7 | 15.9 | 14.6 | 6.1 | 14.7 | 12.4 | 15.4 | 12.3 | 10.5 |
| 2010/11 | 7.4 | 13.8 | 9.5 | 18.1 | 16.0 | 6.4 | 14.3 | 10.7 | 15.3 | 12.4 | 10.5 |
| BALUCHISTAN | | | | | | | | | | | |
| 1999/00 | 11.3 | 34.2 | 4.4 | 9.2 | 5.1 | 7.7 | 7.0 | 1.3 | 9.0 | 5.0 | 8.5 |
| 2000/01 | 12.3 | 33.7 | 4.3 | 11.6 | 5.5 | 8.2 | 6.9 | 1.9 | 8.9 | 5.0 | 9.0 |
| 2001/02 | 13.4 | 30.7 | 5.1 | 9.0 | 5.8 | 8.8 | 6.8 | 2.7 | 8.8 | 5.0 | 9.2 |
| 2002/03 | 15.2 | 27.8 | 3.6 | 8.1 | 5.4 | 10.0 | 6.9 | 2.2 | 8.4 | 5.0 | 9.5 |
| 2003/04 | 16.1 | 23.5 | 4.1 | 7.6 | 5.2 | 10.4 | 7.1 | 1.8 | 8.5 | 5.0 | 9.7 |
| 2004/05 | 13.5 | 20.6 | 6.7 | 8.2 | 5.2 | 9.0 | 7.3 | 1.5 | 8.5 | 5.0 | 9.1 |
| 2005/06 | 12.7 | 19.4 | 7.3 | 8.6 | 3.6 | 8.2 | 4.2 | 2.3 | 5.4 | 2.5 | 7.8 |
| 2006/07 | 12.8 | 18.3 | 7.2 | 10.3 | 3.7 | 8.2 | 5.6 | 1.9 | 5.7 | 2.8 | 8.0 |
| 2007/08 | 13.4 | 17.7 | 7.2 | 10.4 | 3.8 | 8.7 | 7.0 | 1.4 | 5.9 | 3.0 | 8.4 |
| 2008/09 | 12.8 | 17.1 | 7.2 | 11.6 | 3.7 | 8.7 | 7.0 | 1.4 | 5.6 | 3.3 | 8.3 |
| 2009/10 | 13.0 | 15.8 | 7.4 | 11.8 | 3.5 | 8.7 | 7.1 | 1.4 | 5.3 | 3.5 | 8.3 |
| 2010/11 | 12.0 | 15.4 | 7.5 | 11.9 | 3.1 | 8.4 | 7.1 | 1.4 | 5.0 | 3.8 | 8.0 |

Annex 2: Brief on PFM reforms in KP

The Provincial Government of Khyber Pakhtunkhwa in its quest for improved public service delivery to the masses of the province has initiated a series of governance reforms, in partnership with DFID, under its Provincial Reforms Program. One of the main components of its reforms agenda is improved public financial management in the province aiming to achieve aggregate fiscal discipline, allocative and operational efficiencies. Some of the key strategic interventions undertaken by the province for the attainment these policy objectives are:

- **The Integrated Public Financial Management Reforms Strategy:** The Provincial Government of Khyber Pakhtunkhwa unveiled the first ever Integrated Public Financial Management Reforms Strategy during 2011-12. This strategy builds on the objectives of financial management reforms approved by the cabinet, and the findings of most recent Public Expenditure Financial Accountability (Fiduciary) Assessment (PEFA) and the Fiduciary Risk Assessment (FRA). It attempts to address the weaknesses identified within the Fiduciary Risk Assessment (FRA) vis-à-vis to budgeting and to audit (based on PEFA indicators). The aim behind the mitigation strategy is to provide greater credibility to the PFM reform program of Khyber Pakhtunkhwa.
- **Medium Term Budgetary Framework (MTBF) & Output-Based Budgeting:** This new budgeting system was initially piloted in three departments during 2010-11 with its rollout to nine more departments during 2011-12. This year, the provincial cabinet has approved full rollout of output-based budgeting and the following key initiatives were undertaken for a smooth transition:
 - Formulated the three years forward budget estimates for 2012-15 on the basis of macroeconomic indicators.
 - The Medium Term Fiscal Framework 2012-15 to determine the total resource envelop and expenditure pressures thereon.
 - The Budget Strategy Paper 2012-13 approved by the cabinet.
 - Issued three years Recurrent Budget Ceilings to 12 departments for 2012-15.
 - The Cabinet approved three years Block Development Budget Ceilings.
 - Developed Training Modules on PFM & OBB and imparted comprehensive trainings thereon at DDOs level.
 - Effective steering of the budget preparation processes by the senior management of administrative departments through the formation of core teams.
 - Preparation of budget estimates by administrative departments in light of their strategic priorities/plans with appropriate information on performance indicators and targets.
 - Initiation of pre-budget negotiations/meetings with core groups by Finance Department.
 - Development of log frames of all line departments of the province.

- Districts Output-Based Budgeting & Introduction of Conditional Grants:** During the year 2011-12, the provincial government of Khyber Pakhtunkhwa extended output-based budgeting to district level with the introduction of districts conditional grants. This instrument of inter-government transfers was piloted in the Elementary & Secondary Education and Health Departments of Districts D.I Khan and Buner. These districts were selected from the list of ten least-developed districts of the province. The overarching objective(s) of introducing conditional grants is to improve service delivery in Education and Health Sectors at the grass root level and tie operational budget with better results.
- Voices of the People in Budget Making:** Making the budget preparation process more transparent, open, participative and responsive has remained one of the key reforms agenda of the Provincial Government. In this pursuit, the Provincial Government initiated holding pre-budget consultative workshops for greater stakeholders' participation, to make the citizens' voices heard in the budget formulation process. These consultative sessions helped the provincial government in the initiation of a number of innovative pro-poor programs e.g. Bacha Khan Khpal Rozgar Scheme, Benazir Health Support Program etc.
- Internal Audit Functionality:** Realizing the significance of this functionality, the provincial cabinet last year approved the concept of Internal Audit. Consequently, an Internal Audit Charter in light of International Standards for the Professional Practice of Internal Auditing (ISPPA) and best practices in public sector internal auditing was successfully prepared and approved. Initially, it was piloted in Finance Department and an Internal Audit Unit was notified for the purpose. This unit carried out internal audit of payroll and pension which resulted in the identification of cost efficiency of Rs 74 million in pension. Similarly, for the first time computer-based audit of the payroll of the provincial government was carried out. For enhanced value addition to the public money, it has been endorsed by the provincial cabinet to extend this functionality to four other departments of the province during 2012-13.
- Introduction of Business Plans:** In order to enable the line departments to translate their Strategic Plans into Operational/Business Plans for a period of three years in a more consistent, coherent and uniform manner and accordingly to make them accountable for the results, the introduction of annual business plans in three departments as part of their annual budget process has been approved. The Medium Term Budgetary Framework (MTBF) already provides an important base for such operational/business plans.
- Economic Growth Strategy:** The Provincial Government of Khyber Pakhtunkhwa in its efforts to stimulate growth in potential 'growth/priority sectors' of the economy through enhanced public investments and complementary sectoral policies has strategized this intent through Economic Growth Strategy. The strategy marks a paradigm shift in public investments and advocates improvement in service delivery instead of archaic 'Brick and Mortar' development policy.
- Annual Strategy Review:** The Annual Strategy Review (ASR) is the review of developmental strategies and the budgetary allocation process, which has been carried out by the Planning and Development Department for the first time in the history of Khyber Pakhtunkhwa. An amount of Rs 126.678 billion out of the total ADP for 2010-12 was allocated against the CDS allocations of 201.114 billion showing a compliance of more than 67 percent.

Annex 3: Conditional Grants

Service delivery at district level is hampered due to need of resources for operations and maintenance. As a result; schools are in a rundown condition and clinics lack basic facilities. The Finance Department with active support from donors such as DFID, is spearheading an innovative system of conditional grants. Through this system, grants are released to spending units in districts which meet certain conditions. There are many unique features of conditional grants:

- a. These grants are spent on items which have a direct link to service delivery, for example improving the conditions in schools, providing medicine for treatment of poor patients visiting Basic Health Units and vaccines for immunization.
- b. The spending can be directly linked to the targets of Millennium Development Goals. For example, better schools will result in lowering the rate of school dropouts and thus improve the literacy rate.
- c. Districts are required to prepare plans identifying needs, recommendations for meeting those needs, list of activities and targets and costing of activities. Plans are prepared bottom-up with collaboration of communities.
- d. Once plans are prepared and agreed between the Provincial Finance Controller and the concerned district officials, a Memorandum of Understanding is signed between the PFC and the District Coordinating Officer.
- e. In education sector, in order to empower the community, the Cabinet has approved to allow the Parent Teacher Council to undertake construction work up to a limit of Rs 1 million.
- f. Due to the fact that many schools are undertaking construction work simultaneously, the work is completed in time.
- g. PTCs have demonstrated that the cost of construction can be reduced to a considerable degree, if done through community-based organization and monitored vigorously.
- h. The government plans to strengthen this approach by improving the methodology further. Recently cabinet has approved replicating the system to other districts and enhancing the funds for this grant.
- i. This system is an extension of Output-Based Budget introduced by the Government of Khyber Pakhtunkhwa.
- j. Real-time feedback and accountability is introduced through engaging third party private sector firms for external audit and monitoring and evaluation.

Annex 4: Capacity and Knowledge Gaps, the Missing Link in the Reform Process

Public Financial Management system is the channel through which the government provides services to its citizens. An effective PFM system ensures (i) citizens' participation in decision making, (ii) fosters transparency and integrity in financial transactions (iii) allocates scarce resources in a manner that improves service delivery, and (iv) introduces a system of accountability that rewards performance. Government of Khyber Pakhtunkhwa (GoKP) is continuously endeavouring to improve the PFM system through various process reforms undertaken (see Annex 2 and Annex 3).

Finance Department (FD) is the focal point of PFM Cycle. In Khyber Pakhtunkhwa, FD has a proven track record of spearheading reform initiatives that make the PFM processes responsive, participatory, transparent and conducive for better service delivery. Some of these are: (i) participatory budget making process established through the introduction of consultative processes with stakeholders at the provincial and district levels; (ii) budget linked to policy priorities through the introduction of the presentation of the Budget Strategy Paper before the Cabinet; hard budget constraint initiated, ceilings are communicated to the departments at the time of issuance of Budget Call Circular, a step which will make releases more predictable; and, (iii) Output-Based Budget is rolled out across all departments of the GoKP. This new budgeting system links budgetary allocations with strategic goals, objectives and outputs of each department and provides performance indicators and targets. In addition to these reforms, there is strong ownership of PIFRA systems within the Finance Department.

Are these reforms yielding positive results? One structured way of looking at the envisioned improvements in the PFM system is to compare Public Expenditures and Financial Accountability Assessment (PEFA) outcomes overtime. A brief snapshot of comparison between PEFA undertaken in 2007 and 2011⁵² is shown in the table below. From this risk matrix it can be seen that the above mentioned reforms, though impressive, have not substantially improved the outcomes of PEFA assessment over time.

Annex Table 4.1 PEFA Outcomes, Relevant Risk Levels and Possible Reasons

| PEFA Outcomes | Risk level and Trajectory | Possible causes |
|--|---------------------------|--|
| Credibility of the budget | Substantial ↑ | Weak control over Payroll and Pension expenditure, un-predictable transfers, weak planning and under-funding of non salary budget. |
| Comprehensiveness and transparency | Substantial ↔ | Missing macro-economic indicators and lack of information on assets, prior-year budget overrun. Transaction-level data of development budget and pension not entered into the system. Fiscal transfers to district governments require improvement, lack of access to in-year budget execution reports of line departments. |
| Policy-based Budgeting | Substantial ↑ | Debt sustainability analysis not carried out, departments are not preparing medium-term sector strategies and prevalence of umbrella projects and un-allocable development schemes. |
| Predictability and Control in Budget Execution | High ↑ | Modern tools for better cash management required, material differences between fiscal balances as per AG record and SBP. Quality of Payroll record requires improvements, pay and pension controls need improvement, delay in establishing public procurement authority. Capacity gaps in line departments. Internal Audit function does not exist |

⁵² 2011 PEFA was conducted by DFID for health sector, initially as a FRA.

Authorities are aware of this challenge and in response GoKP has adopted an Integrated Public Financial Management Reform Strategy. This strategy maps out the reforms introduced through various inputs and identifies steps that can help with sustaining and institutionalizing these reforms. This document contains guiding principles for any stakeholder who desires to partner with GoKP in its PFM reforms initiatives. Although main focus of the following analysis is on provincial side, but similar kind of analysis needs to be done regarding institutional assessment at district level to assess the strengths and weaknesses to tackle service delivery related issues. A separate dedicated TA can be considered.

The expected outcome of all these initiatives is an improvement in service delivery to citizens through efficient allocation and utilization of resources and process reengineering. All these require dynamic and evolving government machinery that responds to changing ground realities. Despite some pockets of excellence within government structure, disconnect between reforms and their impact on the PEFA scores can partly be explained by lack of capacity within government in general. This view is also endorsed by the findings of Post Crisis Needs assessment (PCNA) which has identified capacity building as critical for the success of PFM reforms. In PCNA it is defined as “The ability of individuals, organizations and institutions to perform functions effectively, efficiently and sustainably”. This capacity development according to PCNA includes, “individual knowledge, skills and motivation, as well as organizational processes, procedures and resources that function within an institutional framework of policies and laws, all of which strive to achieve societal goals”.

GoKP in general, and in FD in particular, realizes this constraints. Authorities at FD feels that capacity development is a cross cutting theme and should be an integrated part of overall reforms initiatives, without which the reforms would not yield desired outcomes. Only a skillful official would appreciate and own reforms and develop processes that facilitate access to critical data, skills and motivation to carry out meaningful analysis, so that the ability of the organization to meet its stated goals is strengthened.

On the request of FD, existing PFM systems, structures and processes were analyzed with a focus to identify key skills and knowledge gaps and process improvements limiting the achievement of intended outcomes of PFM reforms. The following table summarizes the key cross cutting interventions that may enable the GoKP to seamlessly adapt to the evolving reforms process in a manner that the capacity building activities lead to improvement in the PEFA outcomes.

Annex Table 4.2 Improvements in PEFA Dimensions

| Intervention | Improvement in PEFA Dimensions | | | |
|--|--|--|--|--|
| | Credibility of the Budget | Comprehensiveness and transparency | Policy-based Budgeting | Predictability and control in budget execution |
| Information Management | Timely action on variations can improve budget outturn | Improved reporting of capital expenditure, pension payments etc. | Comprehensive reports for informed policy decisions | User friendly budget execution reports enable managers to improve control in budget execution |
| Inter-Provincial PFM Forum | <i>This is a cross-cutting activity and provides opportunities to the provinces to learn from each other and where cost effective, commission joint studies.</i> | | | |
| Enhanced Usage of National FMIS | Real-time budget execution reports discourages excess or under-utilization | IFMIS can be best utilized if all expenditure at transaction level is captured in the system | Timeliness of data for making policy choices and informed decision making | Availability of real-time data ensures transparency and accountability |
| Staff Training | Improved skills to analyze transaction data and detect variances | Motivation and skills to capture data which is un-reported in IFMIS | Improved strategic planning and its linkage with medium-term budgetary framework | Better understanding of Financial Rules, Budget Rules, Procurement rules etc. improved use of real time transaction data |
| Partnership for Research | Improved analytical reports on Pension, Salary and non-salary expenditure etc. | Improving the financial reporting of autonomous organizations like teaching hospitals | Inputs in sector strategies and prioritization of spending | Support in developing procurement rules, monitoring guidelines and internal audit plans etc. |
| Collaboration with Civil Society and Media | Citizens participation in budget formulation can improve budget outturns | Participation in budget formulation and execution improves transparency | Participatory bottom-up planning has greater ownership. Improved inputs in sector strategies | Improved monitoring through civil society organizations for better control |
| Reorganizing FM Sections in the Line Departments | Improved allocative and technical efficiency leading to improved budget outturns | Improved budget and planning sections can help the departments become more transparent and accountable | Integrated and enhanced planning and budgeting cells improves linkage between strategies and budgets | Better communication between line departments and the Department of Finance through IFMIS |

Information Management

For effective financial management, pertinent information must be identified, captured and communicated in a form and timeframe that enables finance managers to carry out their responsibilities. Finance Department needs financial as well as operational information to manage the provincial finances and associated risks. The following table summarizes key information that a finance department would require to manage its operations:

Annex Table 4.3 Information Required by FD for Managing its Operations

| Information | Frequency | Purpose |
|--|-----------|--|
| Expenditure Turnover | Monthly | Effective control over expenditure: to ensure that the total expenditure is kept within the limits of the authorized appropriation. |
| Revenue Turnover | Monthly | Effective control over raising of revenues: to see that all sums due to Government are regularly and promptly assessed, realized and credited |
| Cash Balance Report | Monthly | Prudent management of Government's Accounts held with SBP through effective and timely reconciliation and effective cash forecasting for greater fiscal discipline. |
| Cash Forecast | Monthly | Improved predictability of resources and making effective use of available cash. |
| Debt Reconciliation | Monthly | Informed decisions on debt management through: (i) determining new borrowing requirements, (ii) scheduling loan repayments, and distinguishing between interest and repayments of principal, (iii) measuring realized and unrealized gains/losses on foreign loans and adequately protecting against such losses and (iv) managing Government securities and other obligations in accordance with Government regulations. This includes raising, converting, redeeming and servicing these liabilities as required |
| Government Wide Financial Reports | Monthly | Financial reports serve two broad purposes; the first is to assist users in the allocation of resources. The second purpose is to provide a mechanism to enable an entity and the Government, as the owner of that entity, to discharge their joint accountabilities. |
| Bank Reconciliation | Monthly | An essential component of the accounting system. Without it, there is no guarantee that accounts and reported figures are complete and reliable. |
| Commitments | Monthly | Enables the Government to reflect the allocation of budgetary resources when they are committed instead of when they are paid out, providing financial information earlier than 'budget-to-actual' reports and preventing budget overruns. |
| Resources received by Service Delivery Units | Quarterly | Effective control and monitoring of the actual progress of SDUs against committed level of outputs. |
| Fiscal Reports of State Owned Enterprises | Quarterly | The objective of financial reports of SAEs is to meet the needs of the users of those financial reports, namely: (i) to provide information about the financial position, performance and changes in financial position of the reporting entity and (ii) to discharge the accountability of the entity for stewardship of the resources entrusted to it |
| Internal Audit Reports | Quarterly | The primary purpose of internal audit reports is to provide management with an opinion on the adequacy of the internal control system, and to inform management of significant audit findings, conclusions and recommendations. The aim of every internal audit report is; <ul style="list-style-type: none"> ▪ to prompt management to implement recommendations for change leading to improvement in performance and control ▪ to provide a formal record of points arising from internal audit assignment and, where appropriate, of agreements reached with management |
| External Audit Reports | Annually | Foster greater accountability by ensuring compliance and the most economic, efficient and effective operations of the government to add value to the public resources. Timely mitigation of all risks/misappropriations ensured. |
| Government Wide Financial | Annually | Financial reports serve two broad purposes: the first is to assist users in the |

| | | |
|--|------------------------|--|
| Reports | | allocation of resources. The second purpose is to provide a mechanism to enable an entity and the Government, as the owner of that entity, to discharge their joint accountabilities. |
| Multi-Year Estimates | Annually | Enables the government to make sound budget forecasts on the basis of macroeconomic indicators for the attainment of aggregate fiscal discipline, allocative efficiency and operational efficiency. |
| Estimates of Donor Aid | Annually | Assurance on the amount of budgetary support by the donor community and its proper reflection in the budget of the government for greater predictability of this resource inflow, and its proper utilization for the achievement of agreed objectives. |
| Disbursements by Donors | Quarterly | Steer the timely receipt of money as committed by the donors without jeopardizing the overall fiscal space of the government. |
| Gross Domestic Product | Annual | GDP provides basis for ascertaining tax revenue and allocating expenditure to sectors. |
| Statement of fiscal releases from the federal government as compared to proportionate up-to-the-month share of NFC | Monthly | Identifies gaps in funds committed in NFC and actual releases from the Federal Government |
| Progress against OBB indicators and Targets | Quarterly | Provides information on service delivery targets of the line departments |
| Actuarial valuation of pension liabilities | One time | Improved management of pension liabilities |
| Monitoring and Evaluation Reports | Quarterly and Annually | Feedback on activities undertaken during a fiscal year. |

In this age of information, importance of quality and timely information is critical for any public or private organization. FD receives information from various sources and the flow of information within the department is not well defined. GoKP finance managers are often challenged to make a judgment call because of the issues with the timing and quality of information. There is an opportunity to improve information management within FD that can significantly facilitate decision making and bring efficiency and effectiveness within the system. Another area of concern, though not directly related to PFM issues, is the weak capacity of provincial statistical agency in terms of data collection and dissemination. There is a need to step up the capacity of statistical agency at provincial level. This may be done with a close coordination of Pakistan Bureau of Statistics and/or with partnership with development partner. But the need to have good data in policy making cannot be over emphasized.

Annex Table 4.4 Key Efforts in Facilitating Decision Making and their Potential Impact

| Key efforts | Potential impact |
|---|---|
| <ul style="list-style-type: none"> - Review the information requirements of the FD, existing information flow and sources - Develop a reporting package for the management defining the information types, frequency, source, templates, contents and responsibility - Assign the responsibility of managing department-wide information to a section. | <ul style="list-style-type: none"> - Improved and informative decision making - Efficiency and Effectiveness in PFM |

Inter-Provincial PFM Forum

The Provinces, especially after the approval of 18th Amendment, are facing common challenges and have increased PFM responsibilities. Each province is dealing with the challenges in its own way and there is limited knowledge sharing between them. The provinces can learn from each other's experience and have a dialogue on common issues. An Inter-Provincial Public Financial Management (PFM) forum may be established with Finance Department, Planning and Development Department and Accountant General of each province as its members. The forum may also engage Donors, Civil Society and Academia on issues of common interest.

Finance Department GoKP may take the lead and serve as the secretariat of this forum that can meet every quarter and the venue could be rotated among the provinces, with provinces hosting the events on rotation basis. This can be a good platform for lesson learning and provinces can even commission joint studies on issues which are common to all, like reforming the pension system or linking salary with performance etc. This can also lead to cost efficiencies as each province is carrying out similar reforms but necessarily sharing with each other. For example, if one province has developed software for land automation, then other provinces can adopt it with minimum changes.

Annex Table 4.5 Key Efforts for Improved Inter-provincial Coordination and their Potential Impact

| Key Efforts | Potential impact |
|---|---|
| - Prepare TORs for an Inter-provincial forum and share with other provinces | - Improved coordination among the provinces |
| - Finance Department KP to serve as the permanent secretariat | - Cost efficiency by reducing duplication of efforts |
| - Engage donors, civil society, academia in the process | - Improvements in reforms through better lessons learning |

Enhanced Usage of National FMIS

National Financial Management Information System (National FMIS) can be termed as an information highway for all PFM activities. Despite great progress achieved in the implementation of National FMIS, the full potential of the system cannot be exploited due to reasons that can still be addressed with little effort. There is a need of relatively simpler interventions within the Finance Department, Planning and Development Department and key line-departments for greater usage of National FMIS.

In FD, use of National FMIS is largely restricted to the Financial Management Information Unit (FMIU), while Budget Officers and Budget Examiners are still preparing the budget estimates manually. Moreover, the report generation from the National FMIS is also centralized and any request has to be processed by FMIU. This causes delays in preparing in-year budget execution reports, original and revised budget estimates and annual financial statements. However, the National FMIS that is based on state of the art SAP software has the workflow capability where primary user can enter data directly into the system that can be reviewed and approved by the supervisors. The system also has strong reporting features and customized reports can be prepared as per the management needs. Finance Department can bring efficiency in its existing process by implementing National FMIS on workflow that will avoid redundancy, improve controls and ensure timely information availability.

Planning & Development Department (P&DD), despite being a critical link in the PFM cycle, has remained on the sidelines in most PFM reforms. Annual Development Budget is not integrated into National FMIS and is prepared on a separate system by the P&DD and total budget of a development scheme is aggregated under a single account head. Moreover, the transaction-level expenditure information against development budget is not fed into National FMIS. After the agreement on National Finance Commission Award, the development budget of the Government of Khyber Pakhtunkhwa has almost doubled. To effectively manage the large development budget, decision makers need up to date reliable information as well as effective monitoring that can be facilitated by extending the National FMIS to

development projects. Integrating development budget into National FMIS at transaction level will require a medium term strategy, there are certain short-term steps which can help improve the system.

Pension budget is increasing at a phenomenal rate; from a pension expenditure of Rs 3 billion in 2000-01, the current budget for pension is Rs 22 billion. Recent increase in payroll budget will also contribute to rapid increase in pension payments. Pension payments are not entered into the National FMIS at the transaction level. This can make it an easy target for fraud and manipulation. Pension payment process is cumbersome, encourages corrupt practices and is unfair to senior citizens. The system does not facilitate senior citizens, causing frustration and resentment.

Annex Table 4.6 Key Efforts in Creating Transparent and Comprehensive Budget Data and their Potential Impact

| Key Efforts | Potential impact |
|---|---|
| - Nominate a task force of members from AG office, PIFRA, FD and P&DD to assess the extent of the problem and develop a joint strategy to solve it. | - Availability of transparent, credible and comprehensive budget data |
| - Review SAP R3 Workflow design, systems requirements and prepare a paper identifying gaps and recommending solutions. | - Improved monitoring and accountability of development budget |
| - Arrange end-user training for all budget officers and budget examiners | - Cost and time efficiency |
| - Implement SAP R3 Workflow | - Comprehensive budget |
| - Conduct study and suggest steps to integrate development data in SAP system. | - Timeliness of budget and expenditure reporting |
| - Make ADP classification consistent with the Chart of Accounts | - Reduced errors |
| - Provide simple solutions to help field offices/ projects send transaction data of development expenditure in excel sheets that can be uploaded into the SAP R3 system | - Better monitoring of supplementary grants and re-appropriations |
| - Integrate the project data into SAP system through a simpler off-the-shelf solutions | - Improved budget credibility and predictability |
| - Enter pension data into the system at transaction level. | - Improved service delivery due to better resource allocation |

Staff Training

To effectively manage the public finance, a finance department needs specialized skills set including macro fiscal analysis, development and formulation of economic policy, debt analysis and risk management. These specialized skills are not required at each level of the organization; however, every employee of finance department should have basic understanding of the processes and reforms as well as certain skills like basic computers to perform daily job activities. Keeping in view the working and PFM reforms underway, the KP's Finance Department needs a workforce that can:

- perform macro-fiscal forecasting
- carry out debt sustainability analysis
- prepare analytical reports
- use National FMIS effectively for budgeting and reporting
- effectively use electronic communication tools and office automation software

The major qualification of departmental cadre staff at finance department is Sub-ordinate Accounts Service (SAS) examination or Pakistan Institute of Public Finance Accountants (PIPFA) certification. The syllabus for these qualifications has not been revised in line with the PFM initiatives and reforms, and therefore the employees are not skilled to undertake and adapt to the reforms. There are also no continued professional training opportunities

available to the staff during the service to develop and enhance their skills. Some of the old employees even find it difficult to operate computer and access emails.

The employees of management cadre at FD usually have better training opportunities but are time constrained because of heavy workload. This eventually widens the gap in essential competencies and skills expected from the managers. The reforms underway also require management cadre employees to have a certain level of skill in some specialized areas, like fiscal forecasting, for which focused trainings are required.

SAP usage is also a key skill required within the finance department to institutionalize the National FMIS. There is a requirement of some highly qualified SAP professional and basic SAP usage training for all of the staff. SAP usage is restricted to islands of excellence within FD, while many sections in Finance Department are remote from the SAP system.

To develop its skill set of its work force for effective functioning and implementation of reforms, the Finance Department may consider:

- a. Carrying out a Training Needs Assessment (TNA) to identify the skill gaps and training needs.
- b. Developing an annual training plan based on TNA where all officials should have an opportunity to at least once a year, undergo training in relevant areas.
- c. Organizing mandatory basic computer training for relevant staff.
- d. Organizing basic SAP training for all FM staff and SAP certification level courses for the officials with improved IT skills to develop a pool of SAP master trainers.
- e. Partnering with PIPFA to revise the syllabus in line with the PFM reforms.
- f. Partnering training institutes to develop specific training modules/courses for public financial management professionals.

Annex Table 4.7 Key Efforts in Building Capacity and Potential Outcomes

| Key efforts | Potential impact |
|--|--|
| - Carry out a TNA | - Skilled workforce to better manage the public finances |
| - Prepare and implement annual training plan | - Acceptance of reform initiatives |
| - Mandatory trainings in basic computer skills | - Optimal use of IT systems |
| - SAP trainings and certifications | - Time and cost efficiency |
| - Partnering with PIPFA to revise the syllabus in line with PFM reforms | - Improved control and risk mitigation |
| - Partnering with training institutes to develop specific PFM trainings | - Transparency and efficiency in procurement process |
| - Include procurement trainings as a course in the mandatory trainings for officials | |

Partnership for Research

During the last one decade, the federal government, through HEC has improved the research capacities of private and public sector universities. The Government of Khyber Pakhtunkhwa has undertaken many activities in collaboration with local universities. These include engaging universities in providing policy inputs, outsourcing trainings and conducting third party evaluations. Finance Department prepares Medium Term Macro-fiscal Framework, but due to limited research and information as well as limited capacity, a detailed forecasting of estimated revenue in the medium term is not possible. For example, the Government of Khyber Pakhtunkhwa does not have an estimation of its Gross Domestic Product (GDP). Due to weak capacity, the government of KP depends on the figures provided by the federal government. This may have effect on predictability of resources as each year there is a short fall between

estimated and actual revenue of the FBR. Similarly there are many areas in which partnership with local universities can be beneficial. Some of these could include debt sustainability analysis, preparation of sector strategies, macro-fiscal analysis, PETS, citizens perception surveys etc.—collaboration with universities may not be a one way process and this can be a good source of cross transfer of skills in which the government can engage highly qualified faculty members as senior economists. This can be a win-win solution for all, as the government will benefit from the academia and the academia shall have an opportunity to experience the work environment in the Finance Department.

Annex Table 4.8 Key Efforts for Better Decision Making and Potential Outcomes

| Key efforts | Potential impact |
|--|--|
| <ul style="list-style-type: none"> - Select universities and prepare a list of areas for research and analysis - Sign Memorandum of Understanding with eligible universities - Commission joint studies | <ul style="list-style-type: none"> - Analytical reports and research studies for better decision making |

Collaboration with Civil Society and Media

Civil Society Organizations (CSOs) can significantly contribute towards improving transparency and ensuring accountability at the grass-root level. CSOs cannot take the place of government, but where they are influential they can be good partners in development and bringing the citizens closer to the state. In KP, there is a sizeable number of CSOs that can be a good support in ensuring citizens' participation in planning, budgeting and monitoring. Khyber Pakhtunkhwa has adopted a Monitoring and Evaluation Framework that encourages citizens' participation in monitoring activities. More recently, Khyber Pakhtunkhwa government has proactively engaged with the civil society to solicit their views regarding budget preparation. In this regard four pre-budget citizens' workshops were held: two in Peshawar and one in District Mardan and District Abbottabad respectively. There is a need to further strengthen the dialogue between the government and the civil society that can be a key input for the government in planning, budgeting and budget execution.

During the last few years, communication media has become a very important instrument of accountability. However, the media requires capacity building to understand the issues relating to PFM. Currently, there is limited investigative reporting and 'blame-game' between political parties on television channels is more of a norm. However, if used optimally, media can be a very powerful instrument for bringing about improvements in the PFM systems. Lack of knowledge of various PFM issues can lead to misreporting and this can have adverse impact on the sustainability of reform process. Presently, the primary interaction between government and media is mainly limited to post budget briefings but there is a need to educate media about the PFM processes, reforms and outcomes.

Annex Table 4.9 Key Efforts in Developing Participatory Approach and Potential Outcomes

| Key efforts | Potential impact |
|---|---|
| <ul style="list-style-type: none"> - Set up a forum representing CSOs and government officials, commission joint studies, facilitate citizens' participation in budget making and monitoring. - Arrange seminars, workshops and short training sessions for reporters, covering topics like PFM reforms, Investigative reporting etc. | <ul style="list-style-type: none"> - Participatory and transparent budget - Citizens own and trust government initiatives - Enhanced transparency and accountability - Ownership of the reforms |

Reorganizing Financial Management Sections in the Line Departments

Line Departments have the primary role in ensuring that services are delivered to people in the most efficient, economical and effective manner. Unfortunately, service delivery departments have not emerged as recipients of PFM reform interventions. These line departments have been kept away from PFM related activities for so long that their planning, budgeting and accounting functions have almost atrophied. Resultantly, the PFM reforms have not yet translated into service delivery improvements.

Existing budget process in line departments is largely an activity of compiling expenditure estimates based on incremental approach. Line departments have two separate sections one each for current and development budget. Preparation of current and development budget at line departments are distinct activities and lack coherence and therefore overall department budget may not be aligned to achieve the intended policy objectives. Strategy formulation and monitoring of results are also typically weak inline departments. National FMIS connectivity has been extended to the line departments so they can monitor their financial performance but the use of the system is very limited. Significance in yearly budget reallocations and supplementary grants is a routine.

The new reform puts the ball in the court of line departments but they would need appropriate financial management capacity. The fact that the success of all reform initiatives hinges on the capacity of the line departments to take on a more proactive role in the Public Financial Management, makes it the focus for all future PFM reforms. The existing budget sections in key line departments may be reorganized into FM units with the responsibility of planning, budgeting and financial reporting. However while doing this it must be considered that no PFM reform in KP can be successful without full ownership and participation of the Finance Department. Therefore, for any PFM initiative in line departments to succeed, the role of Finance Department will remain critical.

Annex Table 4.10 Key Efforts of Enhancing Service Delivery in Line Departments and Potential Outcomes

| Key Efforts | Potential impact |
|--|---|
| <ul style="list-style-type: none"> - Improve the skill set in Planning and Budget cells of the line departments through reorganization of units and induction of fresh people either from market or from other spending units - Update M&E Guidelines - Engage staff in a restructured M&E cell - Improve data collection systems like DHIS and EMIS | <ul style="list-style-type: none"> - Improved service delivery - Improved controls for budget execution |

Conclusion—Way Forward

The most important aspect of capacity building is sustainability. Technical Assistance and hiring of skills from the market are short-term solutions. In the longer term horizon, it is important to acquire capacities for individuals, as well as organizations, to themselves conduct and adapt to a complex and changing work environment. Many programs and projects do build parallel systems but these are short-term solutions and mostly unsustainable. The

most durable and sustainable approach is to use, build and modify existing government systems and introduce the learning-by-doing approach.

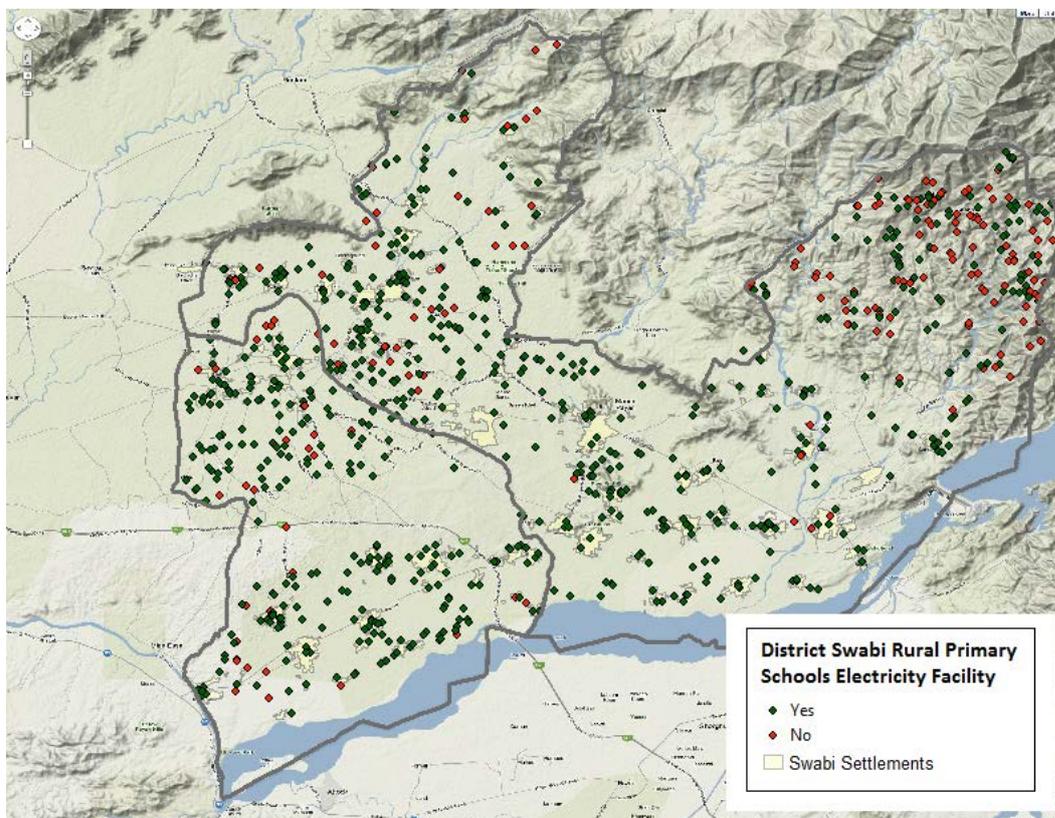
Finance Department has established the MTBF cell to coordinate the PFM reform activities. This cell is responsible for implementation of MTBF and replication of output-based budget, implementation of internal audit function, liaison with PIFRA and coordination and monitoring of output-based conditional grants to districts. Substantial work is done in terms of capacity building within line departments. Each department has a core team which is headed by an Additional Secretary and in some cases the Secretaries of the departments. Therefore a good network exists which can manage change from within and also ensure that reforms are embedded in the government systems. Most important function of the MTBF cell is implementation of the Integrated PFM Reform Strategy of which capacity building is a critical component. Moving forward, it is important to build on the existing activities and use MTBF cell as a nerve center for comprehensive PFM capacity building in KP.

Annex 5: GIS System Utilization in Education Sector Policy

KP is the first province in the country to map all public schools on a GIS system. Detailed analysis of this database can provide several avenues for improved decision making to improve efficiency of expenditures. Analysis conducted on the dataset of Swabi schools is discussed below as an example.

Old urban-rural distinctions need to be revisited to improve targeting of resources and policies in underdeveloped areas. For example, given vast inter-district disparities, district-level data are often analyzed to help targeting decisions by the provincial government. Such analysis, however, may mask substantial intra-district disparities that are not captured by the traditional urban-rural categorization. The fact is that urban-rural distinctions have become increasingly irrelevant because of growth of urban boundaries, steady improvements in road infrastructure and growth of large rural market towns. Targeting policies and resources at pockets of underdevelopment, that may vary widely even within the ‘rural’ band within districts, or perhaps even an urban slum in a large district, are likely to yield substantial dividends. The first map of the Swabi district, a relatively prosperous district near Peshawar, shows that mountainous areas in the northeast have the least resources, and are proxied by a concentration of primary schools without electricity. These schools are shown as small red squares.

Annex Figure 5.1 Availability of Electricity in Rural Primary Schools in District Swabi



Source: Google Earth and WB staff elaboration

To address the question of substantial disparities, even within rural areas, an index for each school to estimate the time taken to travel to the nearest district or tehsil headquarter, proxied among other factors, by distance from a nearest road, may be extremely valuable when developing targeting policies. If such metrics are not applied, policies

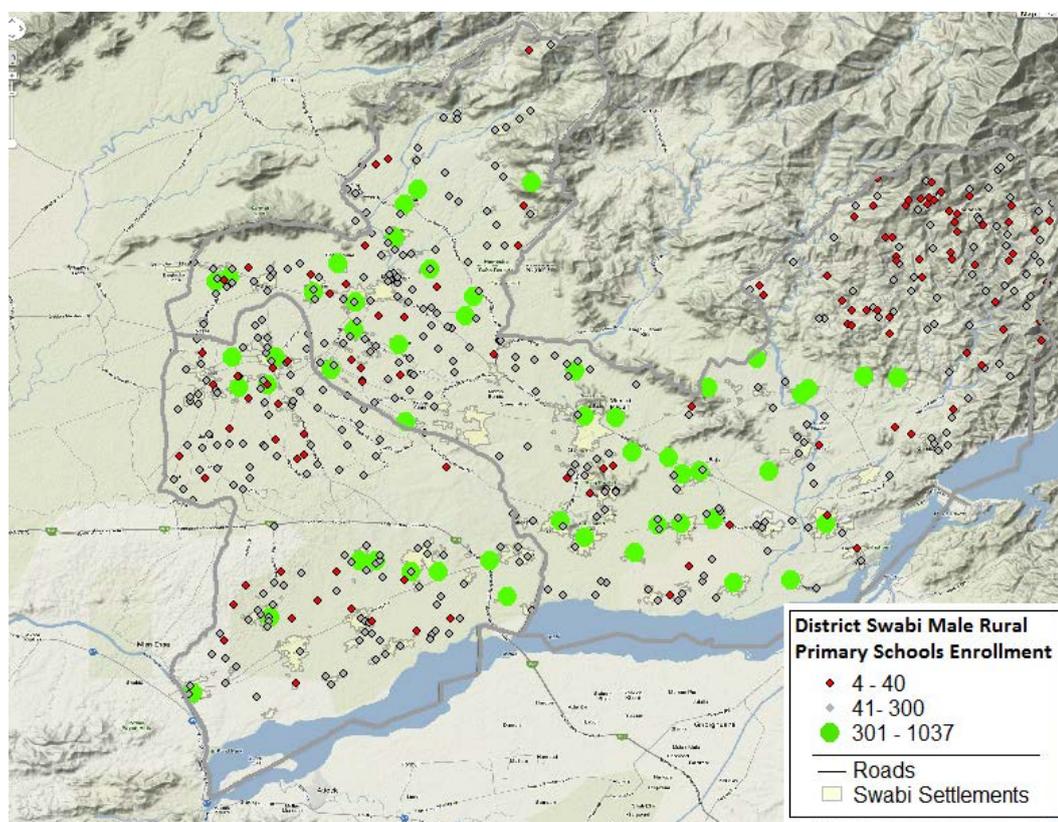
targeting ‘rural areas’—improved incentives to teachers for serving in rural areas, providing more school facilities to rural schools, or providing demand-side incentives, for example—may actually be providing resources to less-needier peri-urban or easily accessible areas.

The second map shows rural primary schools in large settlements located along the main roads. These schools have both large enrollments and large numbers of teachers. There are also 96 schools with enrollments less than 40. These schools are located mostly in underdeveloped, mountainous northeast of the district—the same area that has least electricity for schools. Some are also clustered around the motorway, a major road that, unlike other roads, does not facilitate communication for adjacent villages. Yet others are closely located near schools with high enrollment.

Annex Table 5.1 Number of Girl’s Primary Schools and Enrollment in Swabi

| Swabi Primary School Girls’ Enrollment | Number of Girls’ Primary School |
|--|---------------------------------|
| 5-40 | 96 |
| 41-300 | 262 |
| 301-1037 | 48 |

Annex Figure 5.2 Rural Primary School Enrollments in District Swabi



Source: Google Earth and WB staff elaboration

An even bigger problem that needs to be addressed with extensive GIS analysis is the inefficient co-location of schools. The third and fourth maps show proximity of Swabi boys’ primary schools to each other. They show that 418 of the 549 rural schools are located within 1 km of a similar school. Among the 418 schools, 169 have one or more

schools located less than 500 meters away, and 50 are just 250 meters apart. Several large clusters, shown with red squares, can be spotted in and around large rural settlements in the plains, where traveling distance is unlikely to be a big issue. Merging of school campuses and rationalization of teachers, as Punjab has done successfully, would free-up scarce resources, such as teachers and classrooms to more students without requiring new allocations.

Annex Table 5.2 Swabi Co-locations of Male Rural Primary Schools

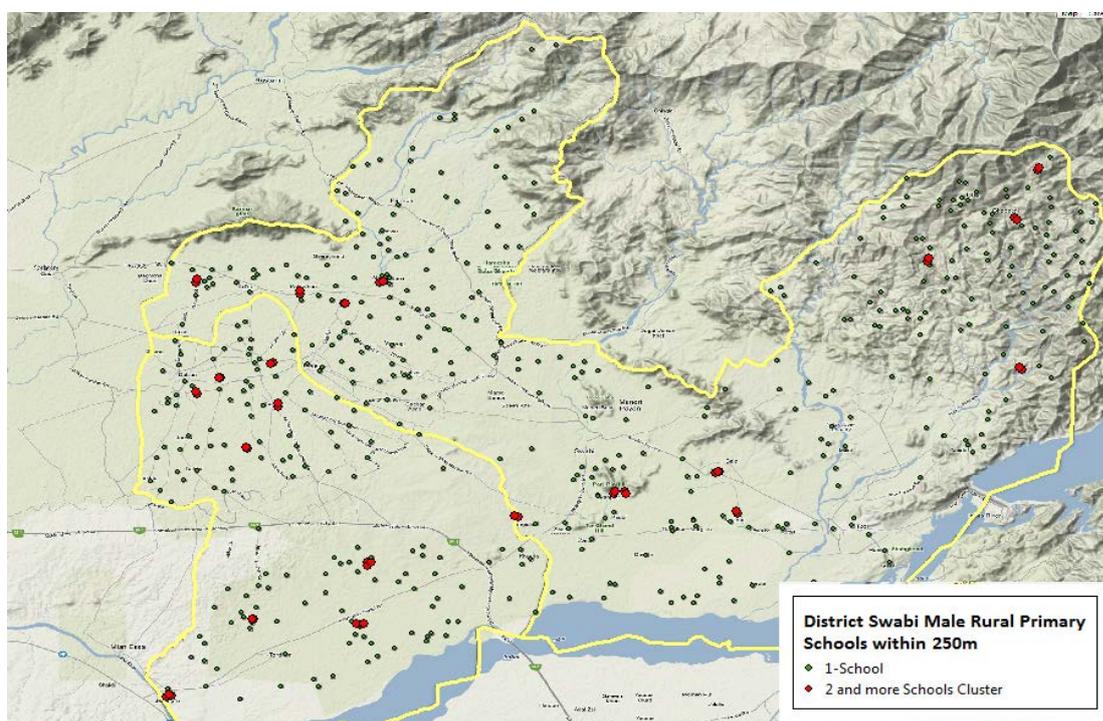
| Number of male primary schools... | 1 km | 500m | 250m |
|--|------|------|------|
| ...with one or more school located within the distance | 418 | 169 | 50 |
| ...with no other school located within the distance | 128 | 377 | 496 |

Understandably, the number of male and female schools located near to each other is much larger. Almost two-thirds of male or female primary schools have another school located within 500 meters. Given that girls already make up some 15 percent of enrollment in schools for boys, as the KP EMIS notes, policy makers should consider allowing co-education in the first two or three school years, where the dropout rate also is high, and thereby save substantial resources.

Annex Table 5.3 Swabi Co-locations of Male-Female Rural Primary Schools

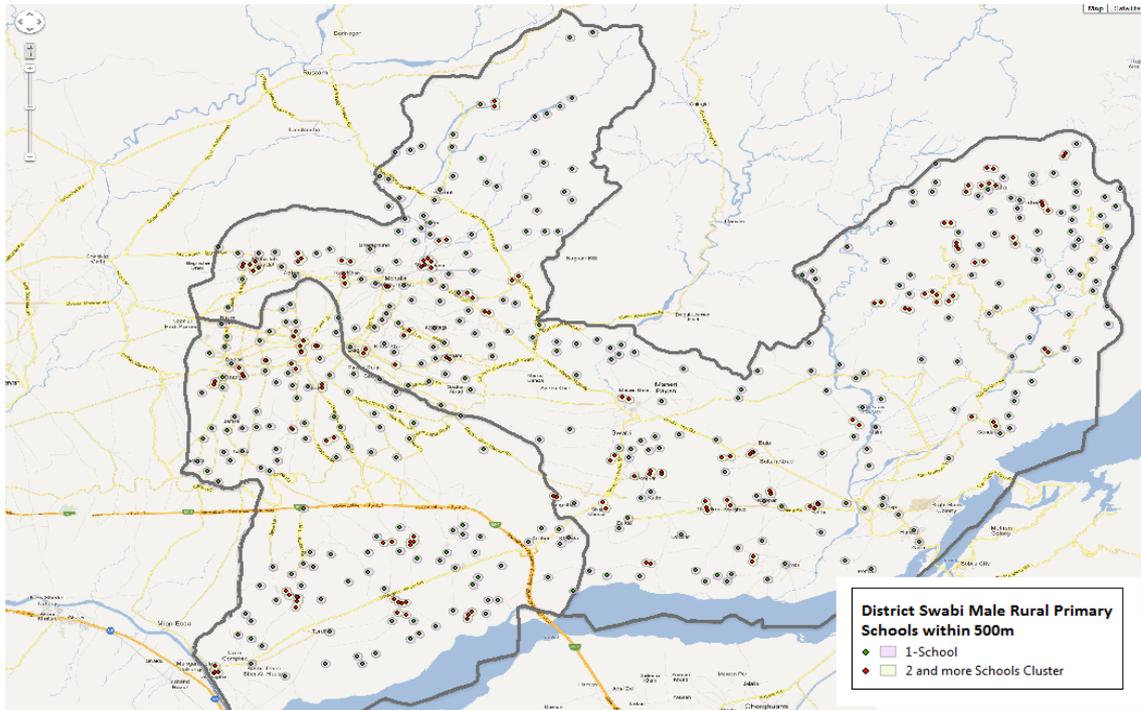
| Number of Male-Female primary schools... | 1 km | 500m |
|---|------|------|
| ...with no other school located within the distance | 75 | 320 |
| ...with one or more schools located within the distance | 877 | 632 |

Annex Figure 5.3 Male Rural Primary Schools Within 250m in District Swabi



Source: Google Earth and WB staff elaboration

Annex Figure 5.4 Male Rural Primary Schools within 500m in District Swabi



Source: Google Earth and WB staff elaboration





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