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Pakistan

Reforming Punjab's Public Finances and Institutions

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Poverty Reduction and Economic Management Unit
South Asia Region



CURRENCY EQUIVALENTS

Currency Unit US\$ 1 = **Pakistan Rupees (Rs)**

= 22.37	1990/91	<i>at Official Exchange Rate</i>
= 24.85	1991/92	
= 25.96	1992/93	
= 30.16	1993/94	
= 30.85	1994/95	
= 33.33	1995/96	
= 38.71	1996/97	
= 42.85	1997/98	
= 50.13	1998/99	
= 51.78	1999/00	<i>at Floating Inter-Bank Exchange Rate</i>
= 58.46	2000/01	

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ABBREVIATIONS AND ACRONYMS

ABS	Annual Budget Statement
ADP	Annual Development Program
AIDS	Acquired Immune Deficiency Syndrome
AIT	Agricultural Income Tax
ARV	Annual Rental Value
AWB	Area Water Boards
BHU	Basic Public Health Unit
BOP	Balance of Payments
CWD	Communications and Works Department
DA	Department of Agriculture
DAs	Development Authorities
DAOs	District Account Officers
DDOs	Deputy District Officers
DDOs	Drawing and Disbursement Officers
EPI	Expanded Program of Immunization
FMRs	Farm-to-Market Roads
FOs	Farmers' Organizations
FPA	Foreign Project Assistance
GDP	Gross Domestic Product
GST	General Sales Tax
HIV	Human Immune Virus
HMIS	Health Management Information System
IMCI	Integrated Management of Child Illnesses
IMF	International Monetary Fund
LGRDD	Local Government and Rural Development Department
MTBF	Medium-Term Budget Framework
MTEF	Medium-Term Expenditure Framework
MVT	Motor Vehicle Tax
NADRA	National Data and Registration Authority
NDP	National Drainage Program
NFC	National Finance Commission
NHA	National Highway Authority
O&M	Operations and Maintenance
OECD	Organization for Economic Co-operation and Development
PAC	Public Accounts Committee
PARB	Punjab Agricultural Research Board
PCUs	Passenger Car Units
PHED	Public Health Engineering Department
PID	Department of Irrigation and Power
PIDA	Punjab Irrigation and Drainage Authority
PIHS	Pakistan Integrated Household Survey
PPHD	Physical Planning and Housing Department
PSC	Punjab Seed Corporation
Rs	Rupees
SAP	Social Action Program
SBP	State Bank of Pakistan
SCARP	Punjab Provincial Private Sector Groundwater Development Project
SMCs	School Management Committees
SNE	Schedule of New Expenditures
TB	Tuberculosis
UNICEF	United Nations Children's Fund
WAPDA	Water and Power Development Authority
WASAs	Water Supply and Sanitation Agencies
WHO	World Health Organization

ABSTRACT

Punjab province (population close to 80 million) is a macrocosm of Pakistan, comprising more than half of total national population and economic activity. Like Pakistan's other provinces and the country as a whole, Punjab has been facing a crisis of public service delivery, government finances, and public institutions and governance. The resulting social and infrastructure "deficits" (shortfalls of spending and service delivery in relation to needs) have contributed to slower economic growth, slower poverty reduction, and poor social indicators in the province.

Nevertheless, Punjab has an opportunity to turn around its public sector, and the provincial government is determined to improve service delivery. Building on promising reform initiatives that it has started during the past several years, the provincial government has been further developing its approach to public sector reforms. This report, which is intended to provide an input for this process, puts forward recommendations for fiscal restructuring, institutional improvements (including civil service reform), and sectoral reforms to improve service delivery in education, health, agriculture and irrigation, and roads.

- ***Fiscal restructuring** needs to focus the public sector on essential core roles and generate more fiscal space for high-priority activities. Key elements would include: (1) improving financial management; (2) revamping planning and budgeting based on a Medium-Term Budget Framework and performance-oriented program budgeting; (3) mobilizing more revenue from taxes and user charges; (4) implementing fiscal decentralization as part of devolution; and (5) containing and managing contingent liabilities (civil service pensions and the liabilities of provincial autonomous bodies).*
- ***Institutional improvements and civil service reform** would include instituting meaningful accountability (both within the civil service and to beneficiaries and the public) and deterring corruption; strengthening key provincial economic management, regulatory, and sectoral institutions; phased rationalization of staffing; much greater emphasis on training; and changes in the terms and conditions of employees to improve incentives and performance. Transparency needs to be enhanced by making detailed information on Punjab's public sector and its performance available to the public. And regulatory reforms are urgently needed to reduce the burden and cost of regulatory harassment on the private sector.*
- ***Reforms in individual sectors** are needed to improve service delivery and development outcomes. Sector reform agendas have in common the need to adjust and better focus the role of government; enhance financial performance (through cost recovery where appropriate); improve the effectiveness and efficiency of expenditures; and strengthen core institutions.*
- ***The federal government has an important role to play in supporting and facilitating provincial reforms, by putting its own house in order (already underway); guiding the devolution process; raising and stabilizing federal revenues; and working closely with the provinces to design the next National Finance Commission Award and civil service reforms.***

PREFACE AND ACKNOWLEDGEMENTS

This report forms part of the World Bank's ongoing dialogue with Pakistan's provinces. The dialogue started in 1999 when there was extensive cooperation with the provinces of Punjab and Sindh in the preparation of a World Bank study of provincial finances (Pakistan: Reforming Provincial Finances in the Context of Devolution: An Eight Point Agenda, Report No. 21362-PAK). This report was finalized in November 2000.

During this process a high-level workshop on provincial finances, led by Pakistan's Ministry of Finance and jointly organized with the Bank, was held in Islamabad on September 17-18, 2000. Participants included key officials of the federal and three provincial governments, headed by their respective Finance Ministers. The revised draft of the study of provincial finances was the main input for this workshop, which provided an important opportunity for open discussion of provincial finance issues between the federal and provincial Ministers of Finance. The workshop helped forge a consensus on the major issues affecting provincial finances and on some broad directions for reform, as well as on the need for regular high-level consultations between the federal and provincial governments on fiscal aspects. Another outcome of this workshop was a request by the provincial Finance Ministers for World Bank support for the formulation and implementation of provincial reform programs.

Subsequently, there have been extensive interactions between Sindh Province and the North West Frontier Province (NWFP) and the Bank on these provinces' reform programs, which have resulted in a series of Bank visits to Sindh to assess and provide technical assistance for the formulation of a provincial reform program. Similar interactions with NWFP have started.

This report is part of a similar engagement with Punjab. Building on earlier and ongoing reform initiatives, the provincial government began to develop a comprehensive reform program in early 2000 and requested the World Bank's assistance in this effort. This initially took the form of a public expenditure review in March-April 2000 followed by the draft version of this report in September 2000, which was discussed with the provincial government in November 2000. Subsequently Punjab has been further developing its approach to reforms. This final version of the report – emphasizing the theme of public sector reform to achieve better service delivery and better economic and social outcomes – is intended to provide an input for this process.

The report was prepared by a World Bank team consisting of William Easterly (task leader), William Byrd (team leader), Ahmad Ahsan, Hanid Mukhtar, Hugo Diaz, Osman Farruk, Amer Zafar Durrani, Fredrick Golladay, Tahseen Syed Khan, Ahmad Jamshidi, and Aiza Aslam. The team visited Lahore during March 26 – April 7, 2000. Additional research assistance was provided by Shaheen Malik. Preparation of the draft version of the report was coordinated by William Easterly, and the report was edited by Al Friendly and processed by Lin Wang Chin. The final version of the report was prepared by William Byrd and processed by Abdul Qadir and Shams ur Rehman.

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EXECUTIVE SUMMARY

1. Punjab province (population close to 80 million) is a macrocosm of Pakistan – comprising more than half of total national population and economic activity. What happens in Punjab has a crucial influence on what happens in Pakistan. The provincial government mobilizes significant fiscal resources (Rs 25 billion in 1999/00) and manages large amounts of budgetary funds (expenditures of Rs 105 billion in 1999/00 – 3% of Pakistan’s GDP and 27% of total national non-interest, non-defense budgetary expenditures). It is responsible for delivery of public services including education, health, water supply and sanitation, irrigation, agricultural research and extension, roads, municipal services, regulation of the private sector, police, and others. The functioning of Punjab’s public sector therefore has a major impact on people’s daily lives, their welfare, the investment climate, and ultimately on economic growth and poverty reduction.

The Crisis

2. Like Pakistan’s other provinces, Punjab has been facing a crisis of public service delivery, public finances, and public sector institutions. The product of progressive, worsening deterioration in the public sector over the past several decades, this crisis has not been manifested in open fiscal deficits (only 1-2% of provincial GDP) but rather in:

- **Lack of fiscal space and a worsening squeeze on total public spending** – Punjab’s real public expenditure growth dropped from 9% p.a. in the 1980s to 1.5% p.a. in the latter half of the 1990s, reflecting federal and provincial resource constraints.
- **A skewed, rigid expenditure structure dominated by high establishment costs** (close to half of total budgetary spending), interest payments, and subsidies.
- **Overextended, partly uneconomic public infrastructure networks and staff-heavy social service networks**, which are fiscally unsustainable.
- **Persistent, worsening under-spending on critical non-salary inputs**, resulting in unrepaired school buildings, shortages of educational materials and medicines, inadequate maintenance of roads, agricultural research institutes without research projects, agricultural extension workers without fuel for visits, and so on.
- **A build-up of contingent liabilities**, including civil service pension liabilities and liabilities of autonomous bodies (non-performing loans from or guaranteed by the provincial government, pensions, potential severance payments, etc.).

3. On the institutional front, the crisis has been manifested by:

- **Overstaffing, weak skills, and lack of capacity in the provincial civil service.**
- **Corruption**, which is widely perceived to be a problem by the private sector and general public.
- **Frequent absenteeism** and substantial mis-deployment of service delivery personnel, such as teachers and doctors.
- **Declining, ineffective, and in some cases non-functioning public institutions.**

4. As a consequence of this crisis in the public sector, **Punjab suffers from large and worsening “deficits” in the funding, delivery, and quality of social services** (education, health, rural water supply). These deficits translate into poor social indicators, significantly worse than those in other countries at the same level of per-capita income. **There are similar**

large gaps for provincial infrastructure (such as roads, irrigation and drainage, and municipal services), which impose a heavy burden on the private sector and general public in the form of higher costs, wear-and-tear on vehicles, delays, and discomfort. The police is widely perceived to be ineffective and corrupt, while judicial services are subject to long delays. The multiplicity of provincial regulatory agencies harass the private sector and discourage economic activity.

The Opportunity

5. In the midst of this crisis, Punjab has an opportunity to turn around its public sector, taking advantage of the following favorable factors conducive to reform:

- **There is a reforming government at the federal level**, which has attacked corruption, improved governance, and engaged in fiscal reforms.
- **The provinces including Punjab have initiated some reforms** and have taken basic steps to restore good governance (some of Punjab's initiatives are listed below).
- Among Pakistan's four provinces, **Punjab is in a relatively good position to carry out and benefit from public sector reforms**. The province has a good agricultural and non-agricultural economic base with substantial growth and tax potential, an entrepreneurial business community, and probably better capacity in the civil service.
- **Pakistan's devolution plan represents a major opportunity**. Devolution is intended to reverse decades of overcentralization of public sector management by creating autonomous, effective, and accountable elected local governments, which would be responsible for provision of local public services.

6. The provincial government has engaged in a number of promising reform initiatives during the past several years, which provide a foundation to build on. Examples include:

- Consolidation and streamlining of provincial taxes, which in the year 2000 were reduced in number from 33 to nine.
- Considerable progress since 1999 in cutting down the excessive number of projects in Punjab's public investment portfolio and the associated "throw-forward" of fiscal liabilities to complete these projects.
- Decentralization of education and health service delivery management to the district level, including a pilot program for health sector decentralization in two districts.
- Conversion on a pilot basis of some public sector hospitals into autonomous entities, with independent management and incentives to improve financial performance.
- Maintenance of existing recruitment bans into regular positions in the provincial civil service, and abolition of many vacant posts.
- Hiring of education, health, and other service providers on facility-specific contracts, with no permanent employment guarantee and no pension rights.
- Introduction of performance budgeting in an initial form in five departments.

7. These reform initiatives have been somewhat fragmented and fall short of what is required. A more focused and prioritized approach is needed. This report emphasizes the theme of public sector reform to achieve better service delivery and better economic and social outcomes. It puts forward recommendations in three broad areas: fiscal restructuring, institutional reforms (including civil service reform), and reforms to improve service delivery in four key sectors (Education, Health, Agriculture and Irrigation, and Roads). The report's findings and recommendations are outlined in the rest of this Executive Summary.

Fiscal Restructuring

8. Fiscal restructuring is at the core of provincial reforms. Punjab has already made some initial steps which need to be built upon, expanded, and consolidated into a strong overall fiscal restructuring program, whose main elements are outlined below.

9. **Improving financial management.** Better financial management – encompassing modern accounting and auditing, improved fiscal reporting and information systems, effective financial controls, and more transparent budget presentation – needs to be the cornerstone of Punjab’s fiscal restructuring. Initiatives at the national level, some of which also involve Punjab, include (1) the initial separation of auditing and accounting, with strengthened autonomy for the former, along with capacity building and technological upgradation; (2) announcement of a new accounting model and system of accounts; (3) creation of Fiscal Monitoring Committees (FMCs) at federal and provincial levels; (4) more timely reconciliation of accounts between line departments and accounts agencies; and (5) establishment of ad-hoc Public Accounts Committees (PACs) to review audit reports in a timely manner and clear backlogs of nearly a decade in some cases.

10. Punjab needs to thoroughly implement financial management reforms. For example, reconciliation of accounts is still delayed and incomplete. The province’s Fiscal Monitoring Committee needs to actively enforce better budget implementation. The provincial ad-hoc PAC, which has already been established and has started work, needs to expeditiously review new audit reports and clear the backlog of old ones. Local governments will be handling a high and growing volume of financial transactions and need to have their accounting system and auditing arrangements established on a sound foundation, fully consistent with practices at the federal and provincial level.

11. **Introducing performance-oriented program budgeting based on a Medium-Term Budget Framework (MTBF).** This new approach would strengthen links between policies, sector strategies and programs, performance, and the budget. The MTBF would be based on and would facilitate programmatic budgeting and prioritization over a multi-year period and would help to achieve a better balance between capital and current spending, between wage and non-wage O&M, and between funding of new project starts and completion of ongoing projects. A medium-term time horizon provides much greater scope for adjusting expenditures that are rigid in the short run – such as the wage bill – and for changing sectoral and investment priorities. The MTBF would roll over each year so that it always has a medium-term time horizon (of at least three years). The MTBF can be introduced in rudimentary form and then improved and refined over time. Critical ingredients of the MTBF process include:

- Assessment of medium-term revenue prospects and expenditure claims, and setting broad spending allocations for sectors and major programs, before detailed annual budgeting.
- Political involvement and commitment, especially in the early stages, which could take the form of Cabinet endorsement of the medium-term framework.
- Comprehensive coverage of all provincial public sector institutions and activities.
- A clear delineation of core government functions and shedding of others.
- Performance-based program budgeting, based on sectoral objectives and strategies, which can build on Punjab’s pilot initiative but with only a small number of key targets/indicators and more systematic monitoring of outcomes to evaluate progress.

12. The MTBF needs to be supported by greater clarity and transparency of budget documents (for decisionmakers and the public), integrated budgeting of recurrent and development expenditures, and changes in budgetary classification and procedures. Greater buoyancy and stability of federal transfers (based on improved federal revenue collections) would facilitate medium-term programming by the provinces. The MTBF also requires capacity building both in the Finance Department and in sectoral agencies – for fiscal analysis and projections, for sector strategy formulation, and for program and performance budgeting. Budget implementation also needs to be greatly improved, and large discrepancies between budget targets and actual spending – which have been the norm – minimized. Ad hoc within-year spending controls necessitated by chronic revenue shortfalls are not appropriate tools for regular budget management.

13. **Containing contingent liabilities.** Punjab's civil service pension liabilities are a time bomb that will explode in the next decade or so if nothing is done. Having jumped from Rs 1.7 billion in 1990/91 to Rs 7.8 billion in 1999/00, pension payments in the provincial budget will continue to increase very rapidly in the absence of remedial action. Accurate information needs to be obtained on the province's public sector pensioners and the costs of pension payments – present and future. This will require a census of current pensioners and detailed data on the age structure of provincial civil servants for actuarial analysis. Undiscounted commutation of up to half of each civil servant's pension entitlement has been a major factor contributing to exploding pension costs when large cohorts of employees retire. This unaffordable (and virtually unique in international experience) benefit needs to be terminated for new employees and modified substantially for existing employees so that the future burden is reduced. Introducing a contributory element to civil service pension financing would also help contain costs. The federal government is considering a package of measures, developed in consultation with the provinces, to rationalize civil service pensions

14. The other main source of contingent fiscal liabilities is Punjab's 119 operational autonomous bodies, ranging from education and health facilities to municipal development authorities and commercial public enterprises. In 1999/00 Punjab's budget allocated Rs 7 billion for the autonomous bodies. The provincial government's outstanding loans to the autonomous bodies, nearly all of them non-performing, total more than Rs 35 billion. An additional Rs 6 billion of bank loans to them have been guaranteed by the provincial government. The 100,000-plus employees of the autonomous bodies represent an unfunded pension liability of around Rs 500 million per year and a much larger potential liability for separation payments. The government has privatized some of these entities, closed others, reduced their fiscal burden somewhat, and used asset sales to retire provincial debt. To make further progress, there needs to be a careful assessment of which autonomous bodies should be retained (due to their clear social/public goods provision function), which privatized or closed down, which merged or restructured, and which transferred to local governments (but with associated fiscal liabilities taken care of). On this basis, privatization, closure, and other actions could go ahead. The pension costs of the autonomous bodies also need to be contained.

15. **Mobilizing more revenue.** Punjab has sharply reduced and streamlined its numerous, mostly low-yielding taxes and strengthened the urban property tax and agricultural income tax. Nevertheless, much more needs to be done to give the province a broader, buoyant tax base.

- The **Agricultural Income Tax (AIT)**, whose receipts are far below the potential yield, can be increased during the next several years to at least Rs 4 billion per year.
- **Urban Property Tax** accrues to local governments, so raising its yield will provide fiscal space for devolution. Receipts could be doubled from Rs 1.9 billion per year at present to at least Rs 4 billion, by further revising the mode of calculation, improving the database, and decentralizing collection as piloted in two urban areas of Punjab.
- **General Sales Tax (GST) on services** Constitutionally belongs to the provinces but at present is collected by the federal government. Receipts can be substantially increased by expanding the list of services covered by GST.
- **Motor Vehicle Tax** could be shared with local governments, and the revenue yield increased in consultation with the other provinces.
- **User charges** have considerable scope for enhancement, particularly for economic infrastructure and urban services, and to a lesser extent for tertiary social services (with careful monitoring and provisions to ensure access to the poor).

16. Restructuring of the tax administration will be essential for sustainable rapid growth of provincial revenues. At present the provincial Board of Revenue and Excise and Taxation Department both collect different taxes. All provincial tax collection functions should be consolidated in a single agency. This consolidation will need to be accompanied by administrative restructuring, skills upgrading, rationalization of staffing, better incentives, accountability mechanisms, and modernization of business processes.

17. **Supporting devolution.** Devolution should not shift the fiscal burdens of the province to the new local governments. Fiscal transfer mechanisms need to be well-designed, since even with strong revenue mobilization by local governments, the bulk of their resources will have to come from the provinces. There is also a need for transitional arrangements initially. In addition, Punjab and the other provinces should (1) create fiscal space for local governments through provincial fiscal restructuring; (2) restructure their civil services consistent with devolution; and (3) take on and effectively handle important new roles like providing technical assistance to the local governments, capacity building, monitoring local government financial management and service delivery, and less intrusive regulation. In dealing with problems like the excessive and uneven staffing of provincial civil servants across districts, the provinces' portfolio of unfinished investment projects, and existing provincial debt, a sound principle to follow would be to avoid putting an excessive fiscal or staffing burden on the local governments but to make sure that they face appropriate incentives for future activities and decisions/investments.

Institutional Reforms

18. Fiscal restructuring without major improvements in governance, more effective public institutions, and civil service reforms will not be successful or sustainable over the longer term. This has been recognized by the Punjab government, which established an Institutional Reform Group that prepared a major report on this subject. Key elements of an institutional reform program are discussed below.

19. **Strengthening institutions.** Priority should be given to strengthening the core economic management agencies (Finance Department and Punjab Planning Board); the tax administration; civil service institutions (most notably the provincial Public Service Commission); the

accounting system (Accountant-General's office and District Accounts Offices); and the police and judiciary; as well as key sectoral agencies.

- In most of these institutions **there are critical qualitative capacity constraints which need to be alleviated** by bringing in key skills on a highly selective basis and developing needed skills through training where possible.
- In some cases **the legal framework needs to be changed**, for example to strengthen and protect the autonomy of the provincial Public Service Commission.
- **Capable, committed management with a long enough time horizon** to make a difference is an essential ingredient for institutional strengthening.
- **Work processes need to be streamlined and modernized** in many of the agencies.
- Institutional strengthening will require **reduction of overstaffing** and where needed **mergers of agencies** or administrative consolidation.

20. **Strengthening accountability for performance.** This crucial ingredient of good governance has been missing. The civil service has been inward-oriented, but internal accountability mechanisms – ranging from staff performance evaluation to bureaucratic checks against irregularities – have been severely eroded. Existing public accountability mechanisms – such as the Public Accounts Committee, legislative review of the budget, public access to information, and complaints mechanisms – have not been working.

21. External accountability to the public needs to be restored and strengthened, and new instruments can be developed. Credible complaint mechanisms and public monitoring arrangements, for example for the police, would be very beneficial. Another promising option is public sector scorecards on service delivery at the local level, accompanied by a good information base, meaningful monitoring, feedback, and performance incentives. Devolution will open up channels for enhancing accountability through local government representatives and councils, citizen community boards, and facility-based beneficiary monitoring. Regular reports to the public on the budgetary situation also will promote public accountability. More generally, transparency needs to be enhanced by making detailed information on the public sector and its performance available to the public. Punjab has made a good start in this regard by establishing a website.

22. Internal accountability needs to be greatly improved, building on recent progress. The federal government has strengthened and given greater autonomy to the Federal Public Service Commission (FPSC), and similar reforms could be implemented in the Punjab Public Service Commission. Punjab has promulgated ordinances similar to those of the federal government enabling mandatory retirement of civil servants after 20 years of service and those found to be inefficient or corrupt. The challenge will be implementing such rules effectively, but a good start has been made in this regard. The provincial government is also working on strengthening the annual performance review process for staff, which needs to be much more job-related and performance-oriented. And finally, strong efforts are needed to fight corruption, an extreme manifestation of lack of accountability.

23. **Reforming the civil service.** Civil service reforms, many of whose elements have been discussed above, will be critical for improving the performance of Punjab's public sector. With its weak existing skill base, Punjab's public sector cannot perform effectively. About one-fifth of provincial civil servants are in the lowest grade, 41% are in the lowest-skilled five grades (out of 22), and staff with poor skills and qualifications are common at all levels – teachers who

cannot pass their own students' exams, untrained health staff, poorly trained policemen, clerical staff lacking basic computer skills. More adequate and relevant skills will need to be built up through a combination of staffing changes and training. In addition to meaningful internal and external accountability, clear objectives and performance targets in core areas of public service delivery are needed. Terms and conditions of employment need to be modified to contain costs and provide appropriate incentives. In this context better, performance-based financial incentives will be needed, but higher pay should be offered only together with inculcation of a genuine performance orientation and containment of establishment costs.

24. A possible sequence of near-term civil service restructuring measures could be as follows:

- **Identify core public sector roles and activities** – which services to provide, which only to fund in part or in full, and which to drop. These crucial choices should not be left to government line departments but should be made instead by a body with adequate public representation and access to needed professional expertise.
- **Set meaningful, realistic objectives for public service delivery** in core areas.
- **Conduct a provincial Civil Service Census** to obtain accurate information on staffing, pay, demographic and skills profiles, and other relevant characteristics.
- **Ascertain staffing needs for management and delivery of core public services** – both numbers of persons in different categories and skills required.
- **Assess the current provincial establishment in the light of devolution and in relation to staffing and skill mix needs** to bring out inconsistencies and major disconnects.
- **Develop and cost different options for addressing these disconnects.** Voluntary retirement schemes, if they are considered as an option, need to be at reasonable cost and cannot be solely at the discretion of staff, to avoid problems of adverse selection.
- As noted earlier, restructuring would also include **improving the skills of existing staff** wherever possible to meet present and future demands, and **bringing in needed skills** where they are not available or achievable through internal training.

25. **Deregulation.** One of the most serious adverse effects of bad governance is the burden of regulatory harassment on the private sector, which raises costs and discourages investment. Although the numerous regulatory laws and rules for the most part are framed by the federal government, implementation occurs at the provincial level. Private sector surveys suggest that frequent visits by factory inspectors (labor, safety, health, environment, etc.) are a significant source of corrupt payments and wastage of management time. A top priority would be to conduct a thorough assessment of existing regulations, with a view to identifying those which are unnecessary or misused and in need of change. Implementation and enforcement need to be improved to minimize the scope for harassment and extortion. For example, inspectors' visits could be limited in number and coordinated in their timing, greatly reducing the number of interactions between individual inspectors and business firms.

Reforms in Selected Sectors

26. Financial and institutional reforms are also needed at the sectoral level. This report focuses on Education, Health, Agriculture/Irrigation, and Roads, but similar reforms are also needed in other sectors. The central objective is to improve service delivery.

27. **Education.** Punjab, like Pakistan as a whole, has not been providing adequate basic education services to its population. The province's public expenditure on education is equivalent to only 2% of provincial GDP (well below that of other countries at comparable levels of per-capita income), and nearly all of it is pre-empted by establishment costs. The province's average direct public spending on elementary education per student in 1997/98 was only about \$27, equivalent to roughly 5% of per capita income (compared to an average of 14% in low-income countries). Only 53% of the province's school-age population is enrolled in public primary schools; the adult literacy rate, measured generously, is about 46% (roughly 34% for women); and only 41% of 10th grade public high school students passed their matriculation exams in 1999. Only half of the children enrolled in the first year of primary school go on to complete four or more years of education, sharply reducing the effectiveness of education expenditures. Massive mis-deployment of teachers (often unqualified) and high rates of absenteeism, as well as chronic underspending on non-wage O&M, reduce the quality of public education services and discourage school attendance. As a result there has been rapid growth of students attending private schools, which now enroll around 40% of primary- and middle-school age children in Punjab.

28. In order to break out of this impasse, Punjab needs to rely much more on parents, teachers, and local communities to play a leading role in a decentralized school system. Devolution, by shifting responsibility for provision of basic public education to the new local governments, has great potential to improve quality by bringing management and operations much closer to the beneficiaries. However, decentralization needs to proceed beyond the local government to the community and facility level.

29. Improving quality will be key to increasing enrollments and completion rates. The provincial government has initiated a number of interventions in this regard, but many of them are costly, and their cost-effectiveness needs to be assessed. The first prerequisite for better quality is teachers' school attendance. Progress reportedly has been made in curbing teacher absenteeism through regular field visit and inspections by supervisory personnel. Enhancing this progress and making it sustainable will require community monitoring, with meaningful input by School Management Committees (SMCs) into performance evaluation of teachers. Increasing and protecting expenditures on critical non-salary recurrent items like teaching materials and maintenance and repairs also will help improve quality. Putting modest amounts of non-salary funds under the control of SMCs, which the province has initiated, is promising but needs to be fully implemented. Plans to create a testing and assessment program should be pursued further.

30. The federal and especially the provincial government need to create a positive enabling environment for private education, while providing appropriate regulation to ensure adequate quality. The possibility of expanding enrollments in targeted categories (based on poverty, gender, lack of access to public education, etc.) through subsidized private provision of basic education should be explored.

31. **Health.** Punjab's health indicators are poor. The infant mortality rate is 95 per thousand, compared to the average of 89 for Pakistan and much lower levels in other South Asian countries. Only 55% of two-year-old children were fully immunized in 1996/97. Public health spending is lower than in other countries and is skewed in favor of salary costs. Preventable communicable diseases are common and very costly to the economy and society. Limited public sector resources for health are not being effectively utilized. Doctor absenteeism may be even more widespread than teacher absenteeism, and government-supplied medicines often are not

available. In many of Punjab's basic public health units, the few patients are outnumbered by the staff (80% of outpatient contacts are with often poorly trained private health care providers).

32. The province has begun to shift health spending priorities away from curative care, a positive trend which needs to be taken further. Top priority needs to be given to the most cost-effective services which improve the health status of the population, especially poor households – i.e. control of communicable diseases, especially the Expanded Program of Immunization (EPI), tuberculosis control, HIV/AIDS prevention, maternal and child health services, and family planning. This change in priorities can be supported by increasing cost recovery in government curative health facilities to a reasonable level, with explicit measures to ensure access for poor households.

33. As in the case of education, devolution opens up opportunities for improving health services, but local governments need to align themselves with the broad health sector priorities outlined above. The private sector is another promising vehicle for improving health outcomes; contracting out certain services and other forms of partnership with the private sector can be explored, with adequate quality control including through supporting training.

34. In an effort to improve health sector performance and efficiency, Punjab has experimented with contract employment of doctors and other health cadres. The provincial government starting in 1999 granted managerial and financial autonomy to some tertiary public hospitals, with good initial results. Additional financial and staffing measures to improve the effectiveness of the health system could include the following:

- Release the non-salary health budget in a more timely fashion, and avoid imposition of ad-hoc spending restrictions and “economy cuts.”
- Procure generic drugs whenever possible.
- Eliminate low-priority vacant posts from the budget and reduce excessive restrictions on the ability of line departments to re-appropriate funds among budget categories.
- Systematically examine the workloads of government health facilities with a view to closing those that are most lightly utilized.
- Reduce the number of unskilled staff in grades 1-4 and general duty medical officers.

35. **Agriculture and Irrigation.** Agriculture accounts for 25% of Punjab's GDP, 47% of total employment, and nearly 75% of the poor. Hence agricultural growth is critical for overall economic growth and poverty reduction, but at 3-4% p.a. since the 1970s, Punjab's agricultural growth has fallen short of its potential. This reflects modest improvements in yields except for wheat and cotton, remaining distortionary pricing and trade policies (despite major improvements in this area), ineffective government agricultural interventions, and the deterioration of irrigation infrastructure and poor water delivery. Punjab's irrigation deficit – measured by the gap between O&M requirements and actual expenditures – is estimated at 30-40%. Irrigation water charges cover only about 35% of O&M spending. Centralized and inefficient management of the irrigation system by the overstuffed Punjab Irrigation Department (PID) has resulted in delivery inefficiencies (only 35-40% of available supplies reach the fields), inequities in water availability (shortages at the points farthest from canal heads), and waterlogging and salinity.

36. Under the National Drainage Program (NDP), Punjab has initiated an ambitious reform of irrigation institutions and finances, which seeks to create a decentralized, participatory,

commercially oriented, and fiscally sustainable institutional framework for irrigation management. The provincial government eventually would be responsible only for sector policy and regulatory oversight. A concerted and sustained effort will be required to make this vision a reality. In this context, PID needs to be restructured and to shed its large excess staff (50% of its current total workforce of some 52,000 people).

37. Punjab's agricultural research and extension systems are not working well and need to be restructured, with a focus on effective provision of core public goods and much greater reliance on the private sector for other services. This would entail:

- Appropriately prioritizing between currently excessive establishment costs and non-salary operating costs (building on improvements made in 2000/01), and between development and recurrent expenditures.
- Divesting remaining activities that are clearly not public goods and services.
- Moving toward public/private partnerships and/or contracting for delivering core public services.
- Reassessing manpower needs (numbers and skill-mix) in the light of changed roles and activities, and adjusting staffing accordingly.

38. **Roads.** Punjab has an overextended road network which needs to be rationalized. According to the provincial government departments concerned, as much as Rs 7.5-8 billion may need to be spent annually on maintenance and rehabilitation (M&R) for this network, but actual spending (despite recent increases) amounts to only about Rs 2 billion per year, leaving a large road infrastructure "deficit". This results in much higher vehicle operating costs and wear and tear, estimated at Rs 8-9 billion per year. If not addressed through a combination of network rationalization and better funding of M&R, the road deficit and its cost to the economy will continue to increase over time. Low road user charges (amounting to less than half of actual spending and a much lower percentage of required spending) are the main factor behind inadequate road spending.

39. Funding is only part of the story, however. Failure to enforce limits on truck axle weights accelerates road deterioration. Several provincial agencies are responsible for managing roads, with lack of coordination among them. Project selection has not been based on an overall sector plan. Funds are spread too thinly across an excessive number of ongoing road projects – which would require more than six years of investment to complete. The provincial Communication and Works Department (CWD) is overstaffed, lacks qualified and skilled professionals, and suffers from antiquated procedures and work methods (all routine maintenance and most periodic maintenance is carried out through force-account). Consultation with road users and their participation in decisionmaking, maintenance, or monitoring is limited.

40. Reforms in financing, institutions, and management are required. Road maintenance needs to be funded through rationalized user charges such as fuel levies, toll taxes, axle-load charges, and transit fees, with existing road-related taxes restructured to improve collections. The provincial government is planning to establish a dedicated Road Maintenance Fund, which would need to have considerable autonomy and a governing body including strong private sector representation. Road user charges would flow into the Fund and then be allocated for M&R. This would involve an integrated multi-year road sector development and maintenance plan for Punjab, with program budgeting on a yearly basis. To support this approach, responsibility for road planning and regulation would need to be unified in a single department. Increased

accountability to users and stronger technical and financial audit procedures also are needed. Competitive out-sourcing of M&R for provincial roads to private firms could be expanded. Some other, more specific improvements would include:

- Freezing new road works until the current throw-forward is reduced to a manageable level; closing lower-priority ongoing works and settling their liabilities; and avoiding large new BOT, BOOT, and other such road development ventures.
- Giving top priority to maintaining roads that have significant traffic and are in fairly good condition.
- Improving human resources through targeted training, better incentives and accountability (job audits and descriptions), and improved recruitment policies.
- Downsizing unskilled staff (grades 1–4), through a combination of natural attrition, early retirement, and possibly a shift to private contract work.
- Developing and enforcing axle load control measures in coordination with other provinces and the federation. (For example, Punjab is setting up weigh stations along newly improved provincial highways.)

The Role of the Federal Government

41. The federal government has a very important role to play in facilitating and supporting reform programs in Punjab and the other provinces. First, it is setting an example by putting its own house in order – for example in the areas of financial management and civil service restructuring. Second, the federal government’s devolution initiative will have a major impact on the provinces. Third, greater buoyancy and stability in federal revenues would significantly improve the provinces’ fiscal positions in the short run, provide much-needed fiscal space, and facilitate provincial planning and budgeting. More specifically, the federal government can:

- **Work with the provinces to devise appropriate fiscal transfer mechanisms for the next National Finance Commission (NFC) Award.**
- **Work with the provinces to clearly delineate the roles of the federal and provincial governments** and reduce organizational duplication and overlap.
- **Reduce vertical fiscal imbalances to the extent possible**, by providing the provinces with broader, more buoyant tax bases where this makes sense and is feasible (e.g. through add-ons to federal taxes like GST or personal income tax).
- **Consult closely and work together on civil service reform.** There are strong legal, structural, and traditional linkages between the federal and provincial civil services, and the federal government normally takes the lead, but the fiscal impact of civil service changes tends to be much greater at the provincial level.
- Ensure that sound financial management systems are established for the new local governments, with effective accountability and provincial monitoring.

1. THE CONTEXT FOR PUBLIC SECTOR REFORMS

1.1 Like Pakistan's other provinces, Punjab has been facing a crisis of public service delivery, government finances, and public sector institutions and governance. This crisis in Pakistan's most populous and economically important province is the product of progressive, worsening deterioration in the public sector over the past several decades. It is not manifested in open fiscal deficits (only 1-2% of provincial GDP), but rather in a whole range of fiscal problems (adverse fiscal trends, worsening structural rigidities, low resource mobilization, inefficient and wasteful expenditures, poor financial management), institutional weaknesses (including an ineffective civil service, dysfunctional public sector entities, and lack of accountability), and inadequate public service delivery (in terms of both quantities and quality). The resulting social and infrastructural "deficits" (shortfalls in spending and service delivery in relation to needs) have been building up over time and are contributing to slower economic growth, slower poverty reduction, and poor social indicators.

1.2 The Punjab government is determined to improve the functioning of its public sector, and to improve public sector service delivery in particular. The province's reform initiatives, while in many cases providing a good start and foundation to build upon, have been somewhat fragmented and fall short of what is required. The provincial government has been developing its approach to reforms, and this report, which emphasizes the theme of public sector reforms to improve service delivery and achieve better economic and social outcomes, is intended to provide an input for this process. The report develops recommendations for reforms in three broad areas – fiscal restructuring, institutional improvements (including civil service reform), and reforms in key sectors (education, health, irrigation, and roads). This chapter reviews the broader context in which Punjab's public sector crisis is unfolding and in which there is an opportunity for reform.

Growth, Social, and Poverty Outcomes in Punjab

1.3 Punjab's economy grew rapidly in the 1980s, by an estimated 6.4% p.a. in real terms between 1984/85 and 1991/92,¹ compared with 5.9% p.a. for Pakistan as a whole. (Available estimates and data on economic indicators for Punjab and for Pakistan are presented in Table 1.1.) This high growth rate could not be sustained at either the federal or provincial level, however, as it was based on temporary factors such as the rapid growth of remittances from Pakistanis working in the Middle East, inflows of aid (partly related to the war in Afghanistan), increases in agricultural productivity which ran their course, growth of protected uncompetitive industries, and unsustainably high federal fiscal deficits and associated rapidly increasing resource transfers to the provinces.

1.4 Punjab's economic growth slowed down after 1991/92, to an estimated 4.9% p.a. between 1991/92 and 1994/95 (the last year for which provincial GDP estimates are available). This partly reflected national trends, but the growth slowdown in Punjab was considerably milder than for Pakistan as a whole, whose GDP growth rate declined by nearly two percentage

¹ In the absence of official government statistics on national accounts by province, this figure and others on economic growth and structure in Punjab are based on estimates.

points to 4.0% p.a. during the same period.² Possible reasons for the maintenance of higher growth in Punjab include (1) the law and order problems in Karachi during much of the decade, which resulted in a shift of economic activity in favor of Punjab; (2) Punjab's stronger and more diversified economic base than those of the two smaller provinces (NWFP and Balochistan); and (3) good cotton production in the early 1990s (Punjab is the main producer of cotton and also has a sizable downstream textile industry).

Table 1.1 : SUMMARY ECONOMIC INDICATORS

	1984/85 to 1990/91		1990/91 to 1994/95		1994/95 to 1999/00	
	Punjab	Pakistan	Punjab	Pakistan	Punjab	Pakistan
Population growth rate 1/	2.65	3.00	2.60	2.61	NA	2.25
Average Annual GDP Growth	6.4 ^{2/}	5.9 ^{2/}	4.9 ^{3/}	4.0 ^{3/}	NA	3.7
Average Annual Growth of Budgetary Expenditure	16.3	14.3	11.8	14.7	9.1	10.1
Average Annual Growth of Own Revenue	9.5	14.2	9.5	17.9	13.5	9.6
	1984/85		1994/95		1999/00	
Average Per Capita GDP	312	328	507	499	NA	447
Total Expenditure/GDP	7.8	24.2	7.4	25.3	NA	22.9
Own Tax and Non-Tax Revenue/GDP	1.9	16.2	1.1	17.0	NA	16.5

^{1/} Punjab's population growth rates are based on mid-census projections by the National Institute of Population Studies.

^{2/} The figures provide growth rate for the period 1984/85 to 1991/92.

^{3/} The figures provide growth rate for the period 1991/92 to 1994/95.

1.5 Nevertheless, economic growth in Punjab slowed down significantly in the first half of the 1990s. Moreover, the stagnation of the cotton crop after 1992 and the further decline in the national GDP growth rate in the second half of the 1990s (to 3.7% p.a.) suggest that Punjab's economic growth slowed down after 1994/95. Factors behind lower growth in the 1990s at both provincial and national levels probably included the following:

- fiscal adjustment necessitated by past fiscal profligacy (unfortunately mainly through expenditure cutbacks rather than higher revenues);
- a slowdown in agricultural productivity growth, as Green Revolution gains ran out of steam;
- lack of competitiveness of large segments of Pakistan's and Punjab's industry, exposed by trade liberalization and especially the shift to free trade and international market pricing of cotton;
- political uncertainty (seven different national governments during the 1990s) and significant law and order problems (but more serious in Karachi), which have contributed to a worsening investment climate;
- heavy-handed, often predatory government regulation, which together with the dominance of inefficient public enterprises in key upstream activities (e.g. power, steel) constituted a significant burden on the private sector;
- deteriorating capacity and performance in the civil service and public sector institutions;
- infrastructural constraints and bottlenecks due to insufficient maintenance and inefficient operation of infrastructure assets, as well as inadequate investment in some cases; and

² This implies that economic growth in the other three provinces declined much more sharply, since Punjab comprises about half of total national GDP.

- over the longer run, the drag on economic and productivity growth imposed by poor social indicators, especially low literacy and elementary education completion rates.

1.6 Slower economic growth not surprisingly has had an adverse effect on poverty reduction (Table 1.2). At the national level the estimated poverty ratio (percentage of poor people in the population), which had declined from 46% in 1984/85 to 34% in 1990/91, rose to nearly 30% by 1998/99. In Punjab, comparable estimates indicate that the poverty ratio rose from 24% in 1990/91 to 31% in 1998/99. Moreover, given levels of economic growth in Pakistan appear to have yielded less poverty reduction than would be expected based on international experience.

Table 1.2 : POVERTY AND SOCIAL INDICATORS

	1990/91		1998/99	
	Punjab	Pakistan	Punjab	Pakistan
Poverty Ratio (Head Count) ^{1/}	24.0 ^{2/}	25.0 ^{2/}	31.4	29.7
Gini Coefficient ^{1/}	0.29 ^{2/}	0.28 ^{2/}	NA	0.29
Social Sector Expenditure/GDP	2.7	3.5	2.4 ^{3/}	2.7 ^{4/}
Literacy Rate	36.0	35.0	46.0	44.0
Gross Primary School Enrollment				
Girls	69.0	59.0	68.0	61.0
Boys	91.0	87.0	82.0	80.0
Role of Government Schools (<i>govt. school enrolment as % of total primary enrol.</i>)				
Rural	94.0	95.0	81.0	86.0
Urban	85.0	70.0	47.0	53.0
Total Fertility Rate	6.2	6.4	5.7 ^{5/}	5.9 ^{5/}
Contraceptive Prevalence	7.0	7.0	16.0	17.0
Contraceptive Awareness (<i>% of currently married women 15-49 years who know of at least one family planning method</i>)				
Rural	40.0	36.0	89.0	91.0
Urban	63.0	59.0	94.0	99.0
Infant Mortality Rate (per 1,000 live births)	116.0	122.0	95.0	89.0
Immunization (<i>% of children 12-23 months who are fully immunized</i>)				
Rural	42.0	34.0	52.0	45.0
Urban	50.0	43.0	64.0	64.0
Access to Clean Drinking Water (% of households)	84.0	74.0	93.0	77.0
Access to Safe Water (% of households)	70.0	60.0	80.0 ^{6/}	63.0 ^{6/}

^{1/} Preliminary estimates, based on PIHS/HIES data; poverty is defined on basic needs criterion.

^{2/} The figures are for 1992/93.

^{3/} The figure is for 1994/95.

^{4/} The figure is for 1999/00.

^{5/} The figures are for 1997.

^{6/} The figures are for 1996/97.

Source: Pakistan Integrated Household Survey except otherwise indicated. Social sector expenditure are from the Finance Accounts of the provincial and federal governments.

1.7 The picture portrayed by social indicators (also shown in Table 1.2) is discouraging. Social indicators in Pakistan and in Punjab are considerably worse compared with international norms for economies at similar levels of per-capita income. Moreover, Pakistan's social indicators have been relatively slow to improve when economic growth was more rapid, and they

have tended to stagnate in recent years when economic growth has decelerated. Some of Punjab's social indicators are worse than the corresponding national indicators. For example, the infant mortality rate, at 95 per thousand, is higher than the national average of 89 per thousand. The contraceptive prevalence ratio and population growth rate in Punjab are lower and higher, respectively, than for Pakistan as a whole (although the total fertility rate is lower). On the other hand, the gross primary school enrollment rate and literacy rate are slightly higher in Punjab than in Pakistan as a whole. These relatively small differences are dwarfed, however, by the gap with many other developing countries.

1.8 In sum, Punjab's growth and poverty reduction performance deteriorated in the 1990s, and its social indicators have remained dismal. Although Punjab appears to have grown faster than the rest of the country, this provides no grounds for complacency in view of the significant decline in the province's economic growth rate. Moreover, Punjab's social and poverty indicators are generally no better than the national average. Continuation of the trends seen in the 1990s would be unacceptable and would leave Punjab in an untenable position.

Inadequate Service Delivery and Social and Infrastructure Deficits

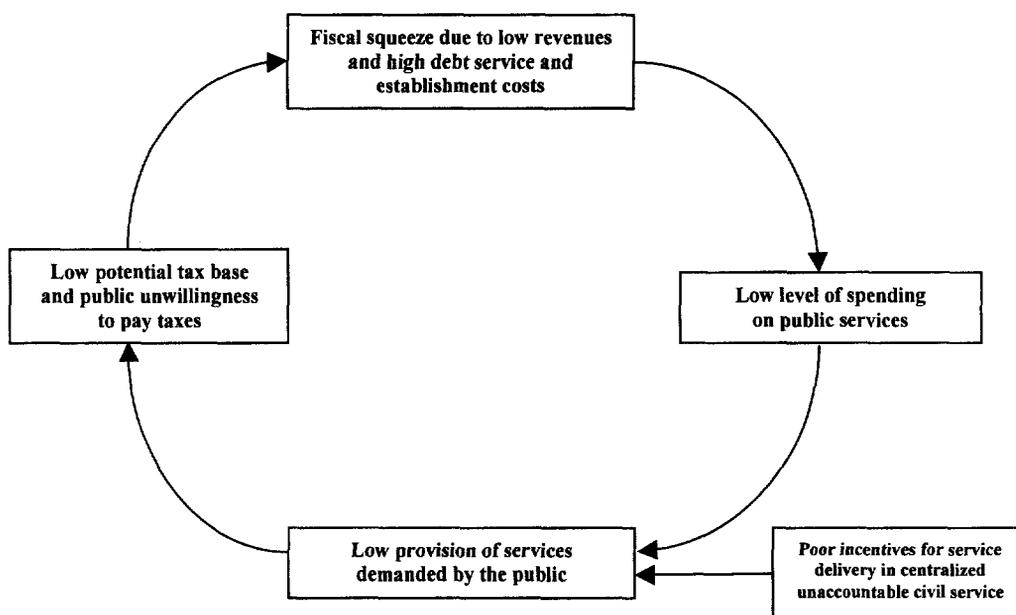
1.9 The disturbing situation and adverse trends outlined above point to public sector failure. Public expenditures in Punjab have not yielded adequate economic and social dividends, and the insufficient provision and poor quality of public services have contributed to the development crisis in the province. Although Punjab does not suffer from high budget deficits and high debt-to-GDP ratios, it faces large "human development deficits" because of inadequate public services in health and education, and high "infrastructure deficits" due to inadequate maintenance of roads, irrigation systems, water supply schemes, and other infrastructure. These deficits contribute directly to low economic growth, poor social indicators, and consequent inability to reduce poverty.

1.10 These deficits in public service provision are not abstract concepts. The infrastructure deficit, for instance, can be concretely defined as the shortfall in development, operation, and maintenance of infrastructure assets (roads, irrigation systems, etc.) relative to what is needed to keep the stock of effectively maintained and functioning infrastructure constant as a ratio to population. Continuing infrastructure deficits will result over time in deterioration of infrastructure and consequent adverse effects on economic activity and growth. Similarly, the human development deficit can be defined as the underprovision of key basic social services (education, health) in relation to what is needed to keep the stock of human capital per capita constant, which results in atrophy of human capital, lower social indicators, and eventually a slowdown in economic growth.

1.11 Rather than continuing to run such public service "deficits", what is required is surpluses to make up for the backlog of past deficits and to keep up with the growth of population and per capita income. As the deficits continue, usable stocks of transport, communications, irrigation, and other infrastructure shrink and human capital stagnates, and the productive capacity of the economy falls and the potential tax base erodes. As tax payments fail to bring satisfactory benefits in terms of public services, the willingness of the population to pay also declines, aggravating the problem of low revenue and further reducing funding available for public services. Public service provision then further deteriorates, making people even less willing to pay taxes, and so on. This is a vicious circle at work. The circle is made up of processes that act on one another to reinforce the negative impact of each, as shown in Figure 1.1.

1.12 This is only one example of the vicious circles – leading to downward spirals in public service provision and economic and social outcomes – that plague Pakistan’s and Punjab’s public sector. Fiscal constraints also impact on civil service pay, benefits, and complementary expenditures, leading to worsening problems of loss of skills and inadequate capacity. These in turn affect the quality of services, contributing to slower economic growth and poor performance in reducing poverty and improving social indicators, exacerbating resource shortfalls and completing another vicious circle.

Figure 1.1: VICIOUS CIRCLE OF PROVINCIAL FINANCES AND SERVICE DELIVERY



1.13 Public sector reforms can play a very important role in improving socioeconomic outcomes, by reducing social and infrastructural deficits and thereby contributing to improved social indicators and infrastructure availability. The vicious circles need to be changed into “virtuous circles” – where better public service provision improves economic and social outcomes and willingness on the part of the population to pay, which leads in turn to greater resource availability, further improvements in service delivery, and so on.

Adverse Fiscal Trends and Structural Problems

1.14 As indicated above, fiscal weaknesses have contributed in a major way to inadequate service delivery. Punjab’s public finances, although in somewhat better shape than those of other provinces, have suffered from long-term deterioration and structural rigidities.³ Budgetary data for Punjab in the 1990s are summarized in Table 1.3. Key trends include the following:

- **Punjab’s own revenue mobilization has been severely eroded over time**, declining from 1.9% of estimated provincial GDP in 1984/85 to 1.1% in 1994/95 (Table 1.1). The province’s own revenues constituted only 20% of total provincial receipts in 1999/00,

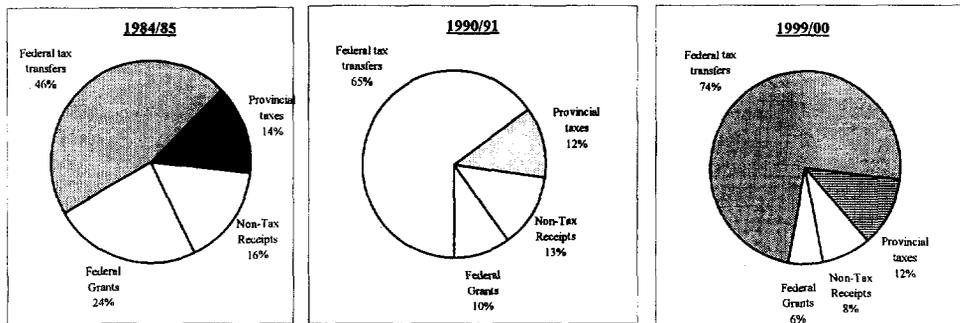
³ See Pakistan: Reforming Provincial Finances in the Context of Devolution: An Eight-Point Agenda (World Bank Report No. 21362-PAK, November 10, 2000), Chapter 1, for an overview of trends in provincial finances.

compared with 30% in 1984/85 (see Figure 1.2). Although Pakistan's provinces do not have access to the most broad-based and buoyant taxes, they have not exploited fully even the tax bases that have been left to them, some of which (urban property tax, agricultural income tax) have good revenue potential. User charges have been to a large extent stagnant (non-tax receipts have been halved as a share of total receipts) and are far below desirable levels.

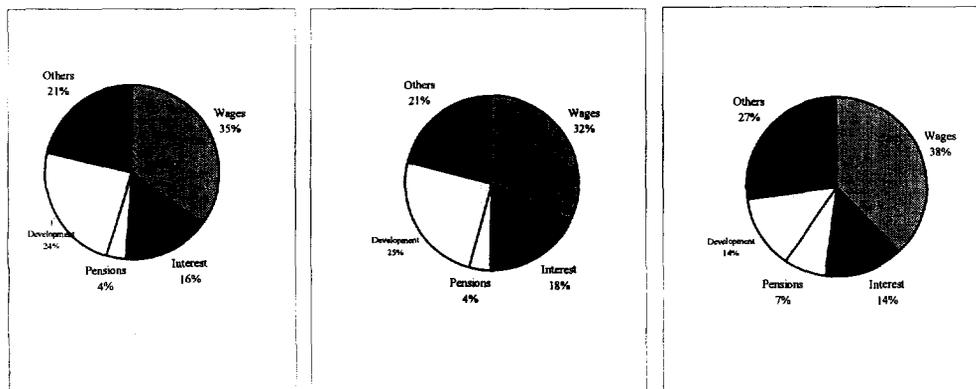
- **Punjab like the other provinces has become excessively dependent on transfers from the federal government to fund expenditures.** Around 80% of the total fiscal resources of Punjab now come from the federal government. This large vertical imbalance means that there is a major disconnect between revenue raising responsibilities and expenditure decisionmaking, which detracts from revenue mobilization incentives and accountability.
- **The 1996 NFC Award made the provinces much more vulnerable to the overall weaknesses of federal revenues,** by shifting from an arrangement which gave the provinces disproportionate shares of the more buoyant federal taxes to one where nearly all federal taxes are shared on an equal basis through a single divisible pool. Reforms that reduced federal tax receipts (such as reductions in customs tariff and income tax rates) translated directly into reduced provincial fiscal resources. As a result of this change, the growth of Punjab's overall fiscal resources declined from an average of 20% per year during 1990/91 – 1996/97 to 5% per year since then.

Figure 1.2: COMPOSITION OF PUNJAB'S REVENUES AND EXPENDITURES

Composition of Provincial Revenues



Composition of Provincial Expenditures



- Basing monthly transfers to the provinces on actual federal tax receipts in the previous month,⁴ starting in 1997, meant that **the chronic short-term shortfalls, volatility, and seasonal fluctuations in federal tax revenues translate directly into similar patterns at the provincial level**, complicating the provinces' expenditure programming and short-term cash flow management.

1.15 As a result of these trends and past poor management, Punjab like the other provinces suffers from serious fiscal structural problems and rigidities, which comprise a major obstacle to better expenditure prioritization and fiscal restructuring. These include:

- **The high share of “fixed” costs in total expenditures.** Together with other largely fixed costs like pensions, interest payments, and subsidies (mainly on wheat), the wage bill pre-empted 72% of Punjab's current expenditures in 1999/00. Generous federal transfers in the 1980s and the first half of the 1990s provided resources to fund provincial government employment growth of 2.5% per year between 1988/89 and 1996/97. This became unsupportable when the resource situation deteriorated in the late 1990s. As a result, the combined share of salaries and pensions in Punjab's total expenditures rose from 36% in 1990/91 to 45% in 1999/00 (see Figure 1.2), reflecting the fiscal squeeze, continuing rapid growth of the wage bill, and an explosion of pension costs.
- **Punjab's annual development program (ADP) also suffers from structural rigidities.** Excessive numbers of new project starts (some of them influenced by past political interventions) have resulted in a public investment portfolio overloaded with too many projects, many of which have doubtful economic returns and which are not likely to be completed in the foreseeable future. In recent years significant progress has been made in reducing the “throw-forward” of expenditure liabilities to complete ongoing projects.
- **Major contingent liabilities – for civil service pensions and for autonomous bodies – are not incorporated into the fiscal framework**, and substantial arrears sometimes build up on certain categories of expenditure (e.g. utility charges). As a result the fiscal picture portrayed by the budget documents is overly optimistic.
- **The fiscal squeeze has forced the provinces including to some extent Punjab into damaging short-run expenditure controls**, such as arbitrary, across-the-board expenditure cutbacks; blanket bans on certain types of expenditure; delaying releases; requiring additional finance department sanction before actual expenditures can occur; and delaying payments to contractors. Recently there has been some modest improvement, with the provinces making up-front releases of funds for important activities (development program, SAP), but these improvements need to be sustained and expanded.

1.16 Punjab also needs better fiscal management tools, processes, and practices. The **budget preparation process**, short-term and input-focused, has not been conducive to effective or flexible prioritization of expenditures. Incremental budgeting – which meant that the bulk of expenditures (in the “permanent expenditure” category) were not seriously questioned or reviewed during the annual budgeting process – imparted even greater rigidity to the structure of expenditures. Full budgeting on the expenditure side for vacant posts, most of which are not filled during the year, has resulted in unrealistically high expenditure budgets in many sectors that are never achieved. This practice provides Punjab a cushion to absorb the inevitable revenue shortfalls, but it is not conducive to sound budget preparation or management.

⁴ The previous arrangement, whereby the provinces got one-twelfth of the total annual budgeted transfer each month (with settlement of any shortfalls at the end of the fiscal year) was more favorable to the provinces because it provided more funds in the early months of the fiscal year when federal tax collections normally are relatively low.

Table 1.3 : SUMMARY OF PUNJAB'S FISCAL ACCOUNTS

	(Rs Million)									
	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual
Total Revenue	28,714	37,940	42,898	50,962	60,743	75,644	84,518	76,343	84,084	97,954
Federal revenue transfers	21,510	29,884	34,560	41,815	50,399	63,103	70,495	59,986	63,383	78,467
Provincial revenues	7,203	8,056	8,338	9,147	10,345	12,541	14,023	16,357	20,702	19,487
Tax	3,523	4,161	4,330	4,485	5,824	6,793	7,944	7,706	9,080	11,344
Non-tax	3,681	3,895	4,008	4,662	4,520	5,748	6,079	8,651	11,622	8,143
							20			5
Total expenditures	43,643	48,444	52,593	52,211	68,088	80,095	77,331	82,089	88,563	105,339
Current expenditures	32,834	37,093	42,659	45,769	56,419	68,290	68,668	69,596	75,977	91,081
Interest	7,955	9,130	10,520	11,945	12,467	12,951	13,669	13,966	14,311	14,743
Subsidies	562	868	532	0	500	1,100	1,500	1,131	2,942	3,500
General administration	2,839	3,700	4,625	4,708	8,122	14,626	11,854	9,530	12,733	13,993
Law and order	3,342	3,709	4,225	4,646	5,491	5,965	6,328	7,027	7,532	8,764
Social services	12,425	13,674	15,361	17,305	21,222	23,373	24,209	27,213	27,751	30,057
Economic services	4,160	4,461	4,951	4,890	5,872	7,323	7,862	7,013	7,058	7,868
Community services	1,262	1,413	2,167	2,109	2,584	2,806	2,841	3,327	3,320	3,092
Grants	220	134	248	137	160	145	88	390	330	9,061
Others	69	4	30	29	0	0	317	0	0	4
Development expenditures	10,809	11,351	9,934	6,442	11,669	11,805	8,663	12,493	12,586	14,258
Fiscal Balance	-14,930	-10,504	-9,695	-1,249	-7,345	-4,451	7,187	-5,746	-4,479	-7,385
<i>Percentage of Estimated Punjab GDP</i>										
Total Revenue	6.0	6.6	6.6	6.6	6.5					
Federal transfers	4.5	5.2	5.3	5.4	5.4					
Provincial revenue	1.5	1.4	1.3	1.2	1.1					
Total expenditures	9.1	8.4	8.1	6.8	7.3					
Current expenditures	6.8	6.4	6.6	5.9	6.0					
Development expenditures	2.3	2.0	1.5	0.8	1.2					
Fiscal Balance	-3.1	-1.8	-1.5	-0.2	-0.8					
Memo Item										
<i>Estimated Punjab GDP (Rs billion)</i>	480	579	648	772	935					

Source: Finance Accounts of the Government of Punjab for all years and estimates of provincial GDP.

1.17 The separate, insulated budgeting of current and development expenditures has resulted in a disconnect between the two, reducing the effectiveness and economic returns of both types of public spending. The ADP is generated through an iterative process that does not put overall resource constraints and the need for prioritization up-front. There is little integration of investment decisions and the associated future development expenditure implications (“throw-forward”) and downstream recurrent spending needs.

1.18 The **budget presentation** is traditionally in the form of five budget documents provided to the provincial assembly – with a sixth, the Performance Budget, added starting in 1999. These documents are complicated and lacking in clarity, making it harder for policymakers and citizens to make informed evaluations of the budget and its implications. The multiple documents do not have a consistent classification and presentation, the summary presentation is not program- and output/outcome-oriented, and the object (economic) classification of expenditures is not presented in an accessible manner. Moreover, the budget presents no information on the provincial government’s contingent fiscal liabilities or on the finances of the provincial autonomous bodies, or (until 2001/02) on local government finances.

1.19 **Budget implementation** is marred by a number of shortcomings. Substantial shortfalls of actual spending in relation to budget targets, in large part attributable to shortfalls in federal revenue collections and corresponding transfers to the provinces, have been the norm. These shortfalls detract from effective budgeting, monitoring, and utilization of public sector resources. Processes for release and spending of budget allocations need to be streamlined, subject to effective monitoring and auditing. Ad hoc within-year spending controls necessitated by chronic revenue shortfalls disrupt program implementation and should not be used as normal tools of budget management.

1.20 **Accounting and auditing** have been major problems because of very limited accounting capacity (particularly at the provincial and local levels), past lack of independence of the Auditor General and his/her dual responsibility for audit and accounts, and lack of meaningful follow-up on audit findings by the legislature or government. Reforms have been initiated at the federal level to improve auditing and accounting, including promulgation of a new charter of accounts and accounting classification; initial separation of the audit and accounts functions (previously both conducted under the auspices of the Auditor General of Pakistan), with greater independence for the former; and computerization of accounts and capacity building. Under the new system, the audit apparatus will be autonomous and will cover all levels of government, while the Controller General of Accounts, who reports to the Ministry of Finance, will be responsible for maintaining the accounts for all levels of government.

Institutional and Civil Service Issues

1.21 Punjab's large public sector, comprising about a million people (including the staff of autonomous bodies and non-regular employees), suffers from serious institutional weaknesses and poor governance, as do the other provinces. Specific problems include:

- An overcommitted, overextended public sector involved in far too many activities, many of which do not fall within the core or desirable roles of government and which in any case are not affordable given present levels of revenue mobilization.
- An overstaffed, inadequately skilled, poorly motivated, and overcentralized provincial civil service.
- Lack of accountability for performance, both internally and to the public.
- Poor management, compounded by very frequent transfers of middle-level and higher-level civil servants.
- Corruption, which is widely perceived to be a problem by the private sector and general public, and leakages in public spending.
- Deteriorating and in some cases non-functioning public institutions.
- Harassment of the private sector by provincial regulatory agencies and consequently high costs and a poor investment climate.
- Lack of transparency in public sector activities.

1.22 The critical need to improve governance and to strengthen public institutions has been recognized by the Punjab government, which has taken some significant reform measures in this regard and also established an Institutional Reforms Group under whose auspices a major report on this subject was prepared. The report provides some useful guidance for reforms in key areas. As mentioned earlier, Punjab has already taken some steps to improve financial accountability, and in areas related to civil service reform (for example new hiring of social service delivery personnel on a facility-specific, contractual basis). These initiatives can be built upon.

1.23 Both the federal and provincial governments have focused on restoring meaningful accountability within the government bureaucracy to promote good governance. The anti-corruption drive has formed an integral part of this effort. While considerable progress can be made by effectively enforcing existing regulations and procedures, major and sustainable improvements will require deeper civil service reforms. Moreover, strengthening of internal accountability needs to be complemented by effective external accountability to the public, including through the public's democratic representatives. Promising initiatives in this area (ad hoc Public Accounts Committees, freedom of information law), need to be fully implemented.

1.24 One of the most serious adverse effects of bad governance is the burden of regulatory harassment on the private sector, which takes up inordinate amounts of managerial time, raises costs, and discourages investment. Although the numerous regulatory laws and rules for the most part are framed by the federal government, implementation occurs at the provincial level. There is great scope for easing the burden of harassment of the private sector under the guise of regulation. Private sector surveys consistently suggest that frequent visits by factory inspectors monitoring the enforcement of various regulations (labor, safety, health, environmental, etc.) are a significant source of corrupt payments and wastage of management time. A top priority would be to conduct a thorough assessment of existing laws and regulations and how they are being implemented, with a view to identifying those which are unnecessary or misused and in need of change. In addition to adjustments of laws and regulations, their implementation needs to be improved to minimize the scope for harassment and extortion.

Opportunities for Reform

1.25 In the midst of the fiscal, institutional, and service delivery crisis described above, Punjab has an opportunity to turn around its public sector. Although the province's fiscal space is limited, institutional capacity has been severely eroded, and the time horizon of the present government is not very long, there are some important favorable factors conducive to reform:

- **There is a reforming government at the federal level**, which has acted to attack corruption and improve governance as well as engaging in fiscal reforms.
- **The provinces including Punjab have initiated some reforms** and have taken basic steps to restore good governance, for example by reducing political involvement in civil service personnel matters. These reforms are ongoing, and Sindh and NWFP have begun to prepare reform plans of a more comprehensive nature.
- Among Pakistan's four provinces, **Punjab is in a relatively good position to carry out and benefit from public sector reforms**. The province has a strong agricultural and non-agricultural economic base with substantial growth and tax potential, an entrepreneurial business community, and probably better capacity in the civil service.
- **Finally, Pakistan's devolution plan represents a major opportunity**. It intends to reverse decades of overcentralization of public sector management by creating autonomous, effective, and accountable elected local governments and giving them responsibility for providing most locally-oriented public services. Therefore it potentially can improve the delivery of these services, which have previously been the responsibility of the provinces.

1.26 Punjab's window of opportunity for reforms needs to be exploited. Otherwise the provincial public sector's deterioration will continue and will become progressively more

difficult to arrest, and prospects for sustained growth, poverty reduction, and social development would be dim.

The Devolution Plan

1.27 Ever since it came into power, the present government has expressed concern about the overcentralized political and administrative structure of the state and its associated lack of responsiveness to or beneficial impact for the bulk of the population, especially the poor. The National Reconstruction Bureau (NRB) was assigned primary responsibility for designing a new system of local government. On March 23, 2000, the federal government announced a bold and comprehensive devolution initiative to provide empowerment, accountability, and better service delivery at the local level. A detailed devolution plan was promulgated on August 14, 2000. Local government elections were held in a phased manner for the lowest level of local government (union councils) starting in December 2000, and have now been completed. It is planned that the local governments and their administrations will become operational in August 2001. More details on the devolution plan are presented in Box 1.1, and a diagrammatic summary is shown in Figure 1.3.

Box 1.1: DEVOLUTION IN PAKISTAN

Pakistan's current devolution plan is not the country's first effort to devolve power to local governments. General Ayub Khan (1958-1969) introduced basic democracies and formed local bodies that managed local affairs and undertook local development schemes. General Zia ul Haq (1977-1988) also conducted elections of local bodies, and Local Government Ordinances promulgated by the provinces in 1979 and 1980 have continued to provide the legal framework for local bodies. The interim government of Moeen Qureshi (December 1993 - March 1994) dissolved all elected local units, fearing that they might use their resources to influence national and provincial elections. Local bodies were revived in Punjab and Balochistan in 1998, only to be dissolved again when the present government took power in October 1999.

Pakistan had more than 4,000 local government jurisdictions in place prior to devolution – rural Districts and urban Metropolitan and Municipal Corporations, and Municipal Committees and Union Councils below them. The average district has somewhat over one million people, but there is great variation across provinces, and the only metropolitan corporations already in place are those of Karachi and Lahore.

Local government structure, especially in urban areas, has been fragmented and complicated by the existence of specialized agencies that are responsible for various local functions but report to the provincial governments. The most notable examples are the urban Development Authorities (DAs) and Water Supply and Sanitation Agencies (WASAs). Moreover, many provincial line departments have offices at the local level and handle the delivery of important services like elementary education and basic public health services. The District Commissioner and Deputy Commissioners, federal civil servants reporting to the provincial government, and other provincial staff, have played a very important role in overseeing local affairs. These features of the administrative milieu have resulted in a high degree of de facto centralization even when local governments were not dissolved. Still another factor weakening local governments has been the extensive involvement of elected representatives of the federal and provincial assemblies in local decisionmaking on development schemes, recruitment and transfers, and site selection.

Under the devolution initiative, a three-level structure of local governments, each of which will have a governing council, is being established – the District governments (around a hundred in Pakistan as a whole), to which many provincial functions are being devolved; the Tehsil (around three per district); and the Union Council (usually 20-30 per district), which typically comprises a number of villages. The devolution plan intends to do away with the artificial demarcation of urban and rural areas and consequent inability to administer newly-urbanized areas and difficulties in taxation and provision of urban services.

Local elections have been occurring in a phased manner. The elections are being held on a non-party basis, with full adult suffrage and with the voting age lowered from 21 to 18 to encourage greater participation. Union Council members and the head (*nazim*) and deputy head (*naib nazim*) of each union council are being directly elected. Each Union Council *nazim* is a member of the District Council, and each *naib nazim* a member of the Tehsil Council. The District *nazim* and *naib nazim* are elected by all of the Union Council members in the district, a process which will occur after all of the union council elections are completed. And the Tehsil *nazim* and *naib*

Box 1.1 Continued

nazim will be similarly elected by all Union Council members in the Tehsil. The District and Tehsil leaders need not be elected Union Council members, however.

A noteworthy feature is the mandated 33% seats reserved for women at all three levels of local government. Additional seats are reserved for workers, peasants, and minorities. Except for the minorities (elected by separate electorate), reserved seats in Union Councils are filled by general election as opposed to the past practice of appointment to these seats which was subject to abuse. Reserved seats in the Tehsil and District Councils are indirectly elected by all Union Council members of the Tehsil or District concerned. Unfortunately, in some areas women have not been allowed by local political groups to contest for seats or even to vote. This practice defeats the purpose of reservation of seats for women and should not be accepted by the federal or provincial governments.

In addition to oversight by the elected councils, Citizen Community Boards and Public Safety and Justice Committees will have official status to monitor local government activities and will work closely with local government departments to ensure effective delivery of key public services. The Public Safety and Justice Committees will perform a special monitoring role with regard to the judiciary and police. The devolution plan calls for local governments to provide matching grants to Citizen Community Boards that demonstrate ability to mobilize community resources for development activities.

The District administration will be led by a District Coordination Officer (DCO), while the District Police Officer (DPO) would be responsible for law enforcement. Both of these officers will be appointed by the provincial government, but the District nazim can ask for transfer of a DCO and/or a DPO, with which the provincial chief secretary has to comply within a week. The rest of the District administration will consist of a maximum of eleven groups of district offices (each headed by an Executive District Officer), to carry out functions related to: (i) Finance and Planning; (ii) Civil Works and Services; (iii) Agriculture; (iv) Health; (v) Education; (vi) Literacy; (vii) Community Development; (viii) Information Technology; (ix) Revenue and Taxation; (x) Law; and (xi) Magistracy. The Tehsil administration will be led by a Tehsil Municipal Officer and will comprise four Tehsil Officers, one each for (i) Finance, Budget, and Accounts; (ii) Municipal Standards and Co-ordination; (iii) Land Use Control; and (iv) Rural-Urban Planning. At the Union Council level, under the executive control of each Union nazim there would be a maximum of three secretaries (Secretary Union Committees, Secretary Municipal Functions, and Secretary Community Development) to assist him or her in discharging Union Council functions.

With the new local government structure targeted to come into being in August 2001, work has been underway to develop a local government law to be promulgated by the four provinces in the form of Ordinances. This is expected to occur shortly. The legal framework will specify local government revenue bases, but with the abolition in 1999 of their main revenue source (octroi and zilla taxes – levies on trade in various commodities across local jurisdictional boundaries), local governments will have to continue to rely mainly on fiscal transfers from the provincial governments. Work has begun to develop a fiscal transfer mechanism for provincial-local resource flows, based on the concept of a divisible pool of provincial resources to be shared with the districts on the basis of specified criteria related to population, backwardness, fiscal effort, and district overheads (see Chapter 6). The actual formulas and parameters would be determined by the Provincial Finance Committee of each province.

1.28 Devolution clearly has considerable potential to expand the delivery and improve the quality of local public services, with consequent beneficial effects for growth, poverty reduction, and social indicators. These improvements are expected to result from bringing decisionmaking and management much closer to the beneficiaries, from making local managers and service providers accountable in a meaningful way to the beneficiaries and local population, and from better information on local needs leading to more appropriate resource allocation.

1.29 Devolution also carries significant risks. One is the possibility of elite capture of local governments, which would then neglect the needs of the bulk of the local population, especially the poor. Even in the absence of elite capture, there is a risk that local governments may not attach sufficient priority to the most cost-effective interventions to improve social indicators or economic outcomes. Service delivery may not improve if the providers and local managers

remain unaccountable. In the absence of sound financial management at the local level, corruption and waste of public funds may not be effectively curbed.

1.30 All of these risks need to be effectively managed in order to realize the potential benefits of devolution. Making sure that the accountability mechanisms called for in the devolution plan work, regularly providing relevant information on local government finances and activities to the public, and capacity building for financial management in the local governments are among the measures that will help minimize the risk of devolution leading to adverse outcomes.

1.31 Devolution all along has been on a very fast track, indeed largely unprecedented in international experience. This great speed, and the absence of a long period of time for technical and other preparations beforehand, has significant implications for both the design and the implementation of the devolution plan. Different elements of devolution have moved forward at different speeds, depending on (1) the extent of resistance from various quarters; (2) the amount and complexity of technical preparatory work required; and (3) the extent of priority and pressure for results from the top leadership. As devolution moves into the implementation phase, its speed will also be affected by (4) availability of financial resources and (5) implementation capacity constraints at the local level.

1.32 Outcomes so far reflect the influence of these constraining factors. For example, local elections have occurred very quickly and for the most part smoothly, reflecting their high political visibility, the top priority assigned to holding them, and the relatively straightforward preparations required. At the opposite extreme, the logical shift of existing provincial civil servants to local government employee status would face serious resistance from the bureaucracy, as well as legal obstacles, and it has been put off for the immediate future. Moreover, the salaries of these civil servants will initially continue to be paid by the provincial governments. Rather than starting out with rationalized local government staffing structures, the existing staffing patterns of (mostly provincial) civil servants across districts will be preserved at first and then would be expected to be gradually adjusted toward normative levels in line with resources provided under the fiscal transfer mechanism. Another example is the legal framework for local governments. After considerable discussion and debate, it has been decided that the legal framework for the new local governments would be provided solely by Local Government Ordinances promulgated by the provincial governments. The alternative approach would have been to give the new local governments a certain status and protections under the Constitution.

1.33 This pattern of flexibility and slower pace of change in the face of resistance has the advantage of allowing the overall devolution program to proceed and not holding it hostage to inability to make rapid progress in a particularly contentious area. Moreover, from a dynamic perspective, as certain elements of the devolution plan are implemented quickly, they might put added pressure on those areas where progress has been slower. Flexibility and compromise are also advantageous in responding to complex situations, where additional information and different perspectives can add value to the package and promote smooth implementation.

1.34 There are also risks, however, in letting key aspects of the design of devolution and the contours of its implementation be excessively influenced by the five factors cited above. For example, if Constitutional protection of local governments would help enhance the sustainability and irreversibility of devolution, perhaps this alternative should have been chosen. The implicit assumption behind the decision to let the local governments start out with existing staffing patterns – that the necessary adjustments in staffing can be accomplished more easily by the

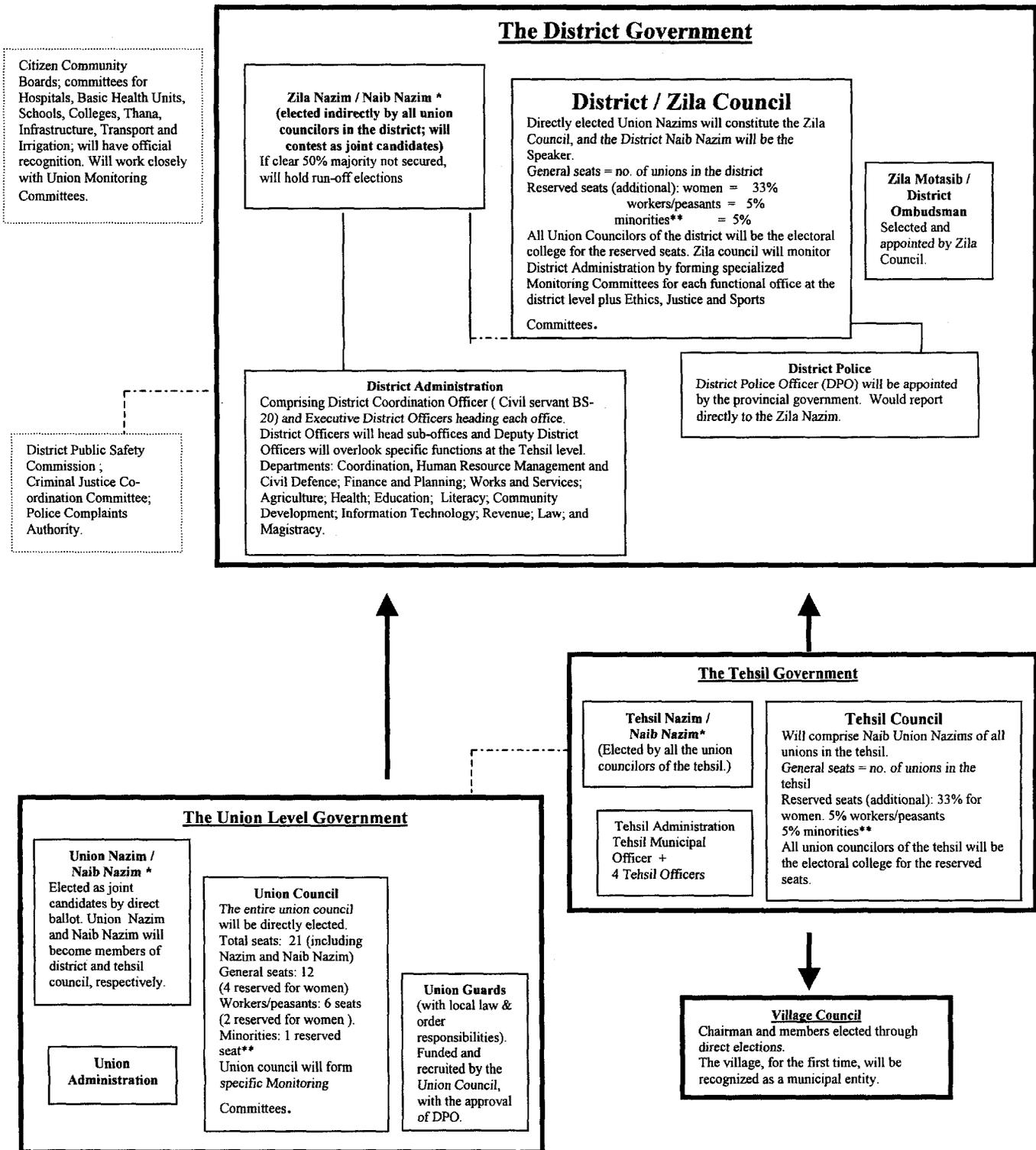
local governments over time than by the provincial governments in advance – may be incorrect. More generally, putting existing provincial public sector burdens on the local governments – as opposed to letting them start out with a more-or-less clean slate – may not be advisable from the point of view of maximizing their chances for success.

1.35 As noted earlier, availability of fiscal resources and administrative capacity will impose constraints on the speed and effectiveness with which devolution is implemented. There is also an urgent need for better information on local public sector activities and their outcomes, which local politicians, government officials, and the public can use to monitor the performance of the local public sector. Another critical need is for sound financial management systems for the local governments, consistent with the financial management reforms that are being introduced at the federal level. This will require capacity building and expansion of the existing District Accounts Offices. Mechanisms to ensure popular participation in and monitoring of local public sector service delivery are called for in the devolution plan and will be critical for its longer-term success. Although in some areas existing community-based organizations, beneficiary groups (e.g. School Management Committees), and NGOs can play an important role in this regard, such popular participation and monitoring in general will not come easily and will need to be encouraged and nurtured. This will also require resources and capacity-building.

1.36 Local governments (as well as the provincial government) should consider the alternative of private provision of local public services where feasible. As recommended for the provincial and national levels, the role of local government needs to be clearly delineated and focused on essential core functions. Another issue is the locus of management of service delivery. International experience suggests that improvements in service delivery come from decentralization of management to the facility level. Although shifting from provincial to district management undoubtedly will be a significant step forward, it would be best to go farther (as envisaged in some of Punjab's social sector decentralization plans) and provide meaningful management authority and, where appropriate, financial autonomy to the service facilities.

1.37 Since devolution represents a major opportunity to improve public sector service delivery, Punjab and the other provinces have an important role to play in ensuring that devolution works well and leads to better service delivery and outcomes as intended. To facilitate and support devolution, the provinces need to (1) help create fiscal space for the local governments, through provincial fiscal restructuring; (2) devise appropriate provincial-local fiscal transfer mechanisms and transitional arrangements; (3) restructure and rationalize their civil services consistent with the needs of devolution; and (4) effectively handle new roles like providing technical assistance to the local governments, capacity building, monitoring local government financial management and service delivery, and less intrusive regulation. In dovetailing Punjab's reform program with the devolution initiative, certain key issues will need to be resolved: excessive and uneven staffing of provincial civil servants across districts; the province's portfolio of unfinished investment projects; and the existing provincial debt. A sound principle to follow in addressing these legacies from the past would be to avoid putting an excessive fiscal or staffing burden on the local governments but to make sure that they face appropriate incentives for future activities and decisions/investments.

Figure 1.3 : THE DEVOLUTION PLAN



* Should have minimum academic qualification of matriculation/secondary school certificate.

** If the population of minorities is greater than 10% of the total population of the constituency direct elections will be held for these seats and only minorities will be eligible to vote.

Punjab's Reform Initiatives

1.38 The provincial government has engaged in a number of promising reform initiatives during the past several years. Examples include:

- Major consolidation and streamlining of provincial taxes, which were reduced in number from 33 to nine in Punjab's 2000/01 budget.
- Some progress since 1999 in cutting down the excessive number of projects in Punjab's public investment program and the associated "throw-forward" of fiscal liabilities to complete these projects (from Rs 38 billion to Rs 24 billion);
- Decentralization of more responsibilities to the district level in education and health management, including expansion of the responsibilities of District Education Officers and District Health Officers, and a more radical pilot program to decentralize managerial and financial authority within the provincial health system in two districts.
- Conversion of some public sector hospitals into autonomous entities, with independent management and incentives to improve financial performance.
- Maintenance of existing recruitment bans into regular positions in the provincial civil service, and abolition of many vacant posts.
- Hiring of many education, health, and other service providers on a facility-specific and contractual basis, with no guarantee of permanent employment and no right to pension under current arrangements.
- Initiation of various budget reforms during the past several years, including introduction of performance budgeting on a pilot basis in five departments starting in 1999 (see Box 1.2).

1.39 Some of the key cross-cutting themes which can guide provincial reform programs, including that of Punjab, were articulated in the agreements reached at a high-level workshop on Reforming Provincial Finances in the Context of Devolution (held on September 17-18, 2000). Participants included the federal Minister of Finance, three provincial Ministers of Finance, and other senior federal and provincial officials. The main points agreed at the meeting are summarized below:

- Redefining the role of government is essential for successful reform of provincial finances – including clarifying the roles of different levels of government, defining core government responsibilities at each level, and identifying activities which can and should be turned over to lower levels of government or to the private sector.
- Inter-governmental fiscal relations need to be improved, through more consultations and by developing a mutually agreed revenue transfer mechanism.
- Planning and budgeting should be strengthened, centered around developing capacity for and putting in place a Medium-Term Budget Framework.
- Provincial revenue generation is inadequate and needs to be enhanced, partly through continuing to strengthen the provincial tax structure but also through enhancing reliance on user charges for economic and higher-level social services.
- Significant improvements in the quality of expenditures are needed.
- Reforms are needed to make the civil service lean and effective in the context of devolution.
- Accounting systems and fiscal transparency should be improved.
- Good governance is essential, and urgent actions are required to eliminate corruption and promote good governance.

1.40 As noted earlier, Punjab's reform initiatives and plans so far have been somewhat fragmented, focused on particular instruments, departments, or services. A more comprehensive approach would be desirable, based on identifying the key constraints – both sectoral and cross-sectoral – that are hindering more rapid growth and poverty reduction, and focusing reform efforts on attacking them. In view of the government's capacity constraints and the short time horizon for taking meaningful, irreversible actions, selectivity and focus are needed in the reform program. While breakthroughs that yield better outcomes in the short run are at a premium, strong initial steps and progress also need to be made in addressing key longer-term problems.

Box 1.2: PUNJAB'S BUDGET REFORMS

The Punjab government has been considering a number of budget reform measures including program-based budgeting and output-based budgeting. The reform approach to date has been somewhat piecemeal, involving ad-hoc additions to the regular budget instructions to line departments rather than a wholesale reassessment of processes, procedures, and institutional arrangements.

In October 1998, a communication was issued by the finance department instructing line departments to rearrange their budgets to accord with their functions, programs and activities, in order to show how these relate to the objectives of the department. In particular, this budget restructuring was intended to:

- reflect the core purpose of each department;
- enable all existing line items to be mapped to the new functions;
- permit physical performance to be measured; and
- budget for each function to be "bifurcated" into salary/non-salary components.

In the process of doing this, each department was instructed to consider:

- Is the activity relevant? Redundant?
- Does it belong with the private sector?
- What is the optimum mix of inputs?

Subsequently, in April 1999 a further communication was issued by the finance department with regard to "zero-based budgeting". Supported by examples from other (reforming) countries, this directive instructed line departments to accompany their budget submissions with an explanatory text describing:

- the duties of the department;
- quantifiable targets for the recurrent and development budgets; and
- an explanatory memorandum on the proposed activities of the department.

In addition, the Punjab government is considering additional reform measures, including:

- Abolishing "redundant" vacant positions.
- Abolishing so called "dead-cadre" posts (i.e. those that are filled but non-performing). The current incumbents in "non-performing posts" would be put in a "surplus pool" for subsequent placement and in the meantime will continue to be paid their base salary.
- Introduction of a functional (i.e. an output) dimension to the budget classification system. It is intended that this would be consistent with the accounting reforms being undertaken through the Project for Improvement of Financial Reporting and Auditing (PIFRA), but initially the functional dimension would be proxied by the organizational classification, suitably modified.
- The establishment of a "forecasting model" for provincial revenues and expenditures.

The 1999/00 budget of the Punjab government marked a first step in this direction. The budget included, as an initial step toward performance budgeting, outputs and corresponding input requirements for five key sectors, compiled in a Performance Budget document. This practice was continued in 2000/01.

1.41 Chapters 2-7 of this report summarize the main issues and put forward recommendations for reform, consolidated in three broad categories: fiscal restructuring, institutional improvements (including civil service reforms), and reforms in four key sectors (Education, Health, Agriculture and Irrigation, and Roads) – including financial and institutional reforms as well as sectoral policy changes. The remainder of this chapter outlines possible roles of the federal government to support and encourage provincial public sector reforms.

The Role of the Federal Government

1.42 The federal government has a very important role to play in facilitating and supporting reforms in Punjab and the other provinces. It can have a major impact in a number of ways:

- First, it is setting an example by putting its own house in order. Ongoing and future federal government initiatives in civil service reform, for example, provide an example and possible guidance for the provinces.
- Second, many federal government actions have a direct impact on the provinces' public finances or public sector activities. For example, federal government decisions on civil service pay almost automatically lead to similar changes at the provincial level, with a far greater fiscal impact given the much larger size of the provincial civil services. The federal government needs to take into account such effects on the provinces in its decisionmaking.
- Third, the federal government's deep involvement in the devolution initiative inevitably will have a major impact on the provinces.
- Fourth, the single most important determinant of the provinces' fiscal space in the short run is federal revenue collections. Greater buoyancy and stability in federal revenues therefore would significantly improve the provinces' own fiscal positions in the short run, provide much-needed fiscal space, and facilitate provincial planning and budgeting.

1.43 These considerations call for regular, close consultations at a high level between the federal and provincial governments on fiscal and other issues of mutual interest, as agreed at the Workshop on Reforming Provincial Finances in September 2000.

1.44 In addition, the federal government needs to focus on several specific areas where there are close linkages between federal, provincial, and/or local reforms. These include:

- **Working with the provinces to devise appropriate fiscal transfer mechanisms for the next National Finance Commission (NFC) Award**, which will be particularly important in the context of devolution and the need for federal-provincial and provincial-local fiscal transfers to be consistent.
- In this context, **working with the provinces to more clearly delineate the roles of federal and provincial governments** and reduce organizational duplication and overlap.
- **Reducing vertical fiscal imbalances to the extent possible**, by providing the provinces with broader, more buoyant tax bases where this makes sense and is feasible (e.g. through add-ons to federal taxes). This would begin to enhance the provinces' revenue autonomy and improve their incentives for better revenue collection and sound fiscal management.
- **A joint effort, with close consultations, on civil service reform.** There are strong legal, structural, and traditional linkages between the federal and provincial civil services, and in most aspects the federal government normally takes the lead. Particularly since the bulk of public services at present are handled by the provinces, federal-provincial cooperation on civil service reform is essential. From a financial perspective, changes in the civil service, its pay, and pensions have a much greater impact on the provinces than on the federal government. Thus the provinces have legitimate concerns about federal initiatives and actions in this area and need to be consulted on major decisions.
- **Ensuring that sound financial management systems are established for the new local governments**, with effective accountability and provincial monitoring. Otherwise there is a great risk that devolution will lead to financial irregularities, which would damage the credibility and sustainability of devolution.

2. EDUCATION

Overview

2.1 Punjab, like Pakistan as a whole, has not been providing adequate basic education services to its population. Only 53% of the province's school-age population is enrolled in public primary schools; the adult literacy rate, measured generously, is about 46% (roughly 34% for women); and only 41% of 10th grade public high school students passed their matriculation exams in 1999. Only half of the children enrolled in the first year of primary school go on to complete four or more years of education. To a large extent reflecting the poor quality of service in public schools, there has been rapid growth of students attending private schools, which now enroll around 30% of primary school age children in Punjab.

2.2 These poor outcomes reflect both inadequate spending and institutional failures. The province's public expenditure on education is equivalent to only a little more than 2% of estimated provincial GDP, well below that of countries at comparable levels of per-capita income, and nearly all of it is pre-empted by establishment costs (the education system has 430,000 staff, 55% of the total number of provincial government employees). There is chronic underspending on critical non-salary recurrent expenditure items like teaching materials and maintenance and repairs. Even worse, the limited financial resources and large human resources devoted to education have not been well-utilized, as a result of overcentralization of management, poor governance, and lack of accountability. The most obvious manifestation of these problems is widespread teacher absenteeism.¹ There is also a serious problem of misdeployment of teachers across localities, with overstaffing in the cities and shortages of teachers in remote rural areas. Many teachers were hired through political patronage and are not qualified for their jobs. Monitoring of teacher attendance, teaching activity, and quality has been grossly inadequate.

2.3 A major, centrally directed effort to expand basic education as part of the Social Action Program achieved only limited success. Punjab needs to rely much more on parents, teachers, and communities to play a leading role in a decentralized schooling system. As the provincial government recognizes, improving quality will be key to increasing enrollment, attendance, and completion rates. Increasing and protecting expenditures on critical non-salary items will help improve quality. Management of such funds should be decentralized to the facility level, and there needs to be meaningful input from parent-teacher associations into teachers' performance evaluation (including monitoring of absenteeism). Assessment of learning outcomes at grade 4 and grade 8, as is planned by the provincial government, would provide useful benchmarks for evaluating the performance of the education sector. The federal and especially the provincial government need to create a positive enabling environment for private education, with appropriate regulation to ensure adequate quality. Finally, there is potential for devolution to improve the quality of basic education by bringing its management and operations much closer to the beneficiaries and thereby fostering meaningful accountability and strong incentives for quality service provision.

¹ Province-wide data on actual teacher absenteeism are not available, but indications from individual facilities and localities suggests that it is common. The March 2000 Third Party Validation Report by the Auditor General of Pakistan found that only 26% of the responding Education Offices at different sub-provincial levels in Punjab had a system for monitoring and discouraging teacher absenteeism that was deemed adequate.

Education Policy

2.4 Punjab has long recognized the government's responsibility to ensure that its citizens are adequately educated. The provincial government has set ambitious targets for increasing enrollments, the literacy rate, and primary school completion rate. It has sought to ensure that there is sufficient investment, adequate quality in the classrooms, and fair access to education, regardless of income or gender. The policies it has pursued toward these ends, however, need to be carefully evaluated for their cost-effectiveness and adjusted as needed.

2.5 The Department of Education has correctly focused on the low enrollment rates in government schools and the high wastage rates, especially in primary and middle schools. To deal with these problems, it has begun various initiatives to improve quality, including distributing free textbooks to needy students; providing incentives and recognition for good teaching; improving in-service teacher training; investing in schools and facilities targeted at attracting out-of-school children; introducing computers in selected facilities; strengthening monitoring and evaluation and inspections; and introducing a chief education officer at the district level. In addition to the Department's efforts to improve recreational facilities at schools and introduce English in all primary schools, the federal and provincial governments have initiated a program to recruit contract employees to teach science and mathematics and have developed a new curriculum for science. The estimated cost to Punjab of all of these activities in 1999/00 was Rs 1,184 million – equivalent to 6% of the provincial education budget and 2.6 times as large as the combined budgets for instructional materials and maintenance and repairs.

2.6 Other initiatives by the provincial government seek to increase enrollment and retention of students, particularly girls. Among them are constructing boundary walls and latrines in order to create a more secure and protected environment and providing scholarships to girls to encourage parents to allow them to attend school. Subsidies to families with several children in school, penalties for teachers who physically punish students, and closer monitoring of teachers' attendance also have been introduced. Regular field visits and inspections by supervisory personnel reportedly have significantly curbed teacher absenteeism in recent months.

2.7 If anything, Punjab's education sector may be taking on too many different initiatives. Many interventions have been piloted, but none has been formally evaluated. Policymakers need to know what works and what each intervention costs, so that an effective and efficient program can be put in place. Particular attention needs to be given to the effectiveness of interventions taken in combination, since it is likely that the effect of two or more interventions implemented jointly will be smaller than the sum of their individual effects. Thus there is an urgent need to assess the cost-effectiveness of these initiatives before spending substantial resources on them.

Education Spending and Budgeting

2.8 As noted earlier, the public education budget represents only about 2.1% of estimated provincial GDP for Punjab, about half the share reported for countries with similar levels of per capita income. Punjab's level is 67% of the GDP share reported by India and 62% of that of Sri Lanka. This is unacceptably low, even correcting for the fact that tertiary education receives substantial federal funding which is not included in the figure for Punjab.

2.9 As can be seen from Table 2.1, the provincial government has appropriated well over half of the education budget to grades Kindergarten to eight in recent years and about a quarter to secondary education (grades 9-12). Professional/technical training and higher education have each received about 10% of the total. Administration of Punjab's education system, including testing and assessment, school inspections, and general administration, consumes less than 1.7% of the total provincial education budget.

Table 2.1: EDUCATIONAL EXPENDITURES BY LEVEL OF EDUCATION
(Current and Development Expenditures)

	1994/95		1995/96		1996/97		1997/98		1998/99		1999/00	
	Rs.m	%										
Primary	9,140	54	10,433	54	10,331	54	13,389	58	12,907	57	13,930	59
Secondary	4,207	25	4,807	25	4,911	25	5,255	23	5,331	24	5,822	25
Tertiary	1,462	9	1,748	9	1,801	9	1,948	8	1,989	9	2,240	10
Profes/Tech	792	5	875	5	935	5	914	4	1,072	5	427	2
Others	1,446	8	1,281	7	1,303	7	1,414	6	1,364	6	1,031	4
Total Education	17,049	100	19,144	100	19,281	100	22,921	100	22,663	100	23,451	100

Source: Government of the Punjab, Finance Accounts (1990/91-1999/00), Combined Finance Accounts (1990/91-1999/00).

2.10 Average per-student direct spending on elementary education was Rs 1,338 (approximately US\$27) in 1997/98, equal to 5% of Punjab's per-capita income, compared to an average of 14% in low-income countries. Out of the elementary-level total, Rs 1,294 per student (97%) was allocated for teacher's salaries (see Table 2.2). The salary budget has been substantially underspent in recent years, however. Only Rs 43 per student was budgeted for all non-salary costs, and within this, the allocation for teaching materials was merely Rs 18 (US\$0.36) per student, a level far too low to facilitate quality education.

Table 2.2: DISTRIBUTION OF SCHOOL BUDGET ACROSS FUNCTIONS

	Salary Budget		Non-Salary Budget		Total	
	Rs mil	%	Rs Mil	%	Rs Mil	%
Elementary Education	19,178	96.8	633	3.2	19,812	74.5
Secondary Schools	5,830	96.9	188	3.1	6,018	22.6
Professional/Technical	156	94.5	8	4.8	165	0.6
Special Education	93	73.2	34	26.8	127	0.5
Administration					442	1.7
Other					47	0.2
TOTAL	25,257	94.9	863	3.2	26,611	100.0

2.11 Since it was launched in 1992, the Social Action Program (SAP) has stressed the importance of education, but despite some initial success in increasing spending on basic education, there was a subsequent reversal due to fiscal and implementation constraints. By the end of the decade there was no significant increase in average spending per student in inflation-adjusted terms compared with the 1992 level. Even though non-salary inputs have been particularly emphasized, the amount actually allocated for them has remained almost constant in real terms. In addition, restrictions on the use of the non-salary budget – particularly withholding funds from School Management Committees (SMCs) that do not have a member

trained in the use of public funds – have resulted in underspending of budget allocations for non-salary expenditures. Utilization of the education budget has frequently been blocked by temporary freezes on hiring of staff and purchase of vehicles and other durable goods and by ad hoc delays in the pre-approval of expenditures by the Finance Department.

2.12 The education budget for primary and middle schools is prepared centrally, using staffing norms and standard allocations for teaching materials and for maintenance and repair (M&R) of classrooms. The latest norms for staffing of schools are summarized in Table 2.3. However, in many schools the actual student-teacher ratio exceeds the norms – due to non-filling of posts, teacher absenteeism, and the like.

Table 2.3: STAFFING NORMS FOR PRIMARY SCHOOLS

<i>Number of Students in the School</i>	<i>Number of teachers</i>	<i>Maximum Student:Teacher</i>
Fewer than 60	2	30
60 to 100	3	33
100 to 140	4	35
Greater than 140	one for every 40 students	40

2.13 Since only about 70% of sanctioned positions in Punjab’s education sector are actually staffed, realized spending has fallen short of the education budget target by as much

as a quarter in recent years. In 1998/99, Rs 6,350 million out of the salary budget of Rs 19,542 million remained unspent at the end of the year. This practice of budgeting for unfilled sanctioned posts, resulting in substantial underspending of the education budget, provides a “cushion” for Punjab in the event of a shortfall in federal or provincial revenue collection, but it also makes annual budgeting for education much more uncertain and less transparent.

2.14 The budget for non-salary items is distributed on the basis of the number of classrooms. In 1999/00, Rs 1,733 was budgeted for each classroom for the purchase of instructional materials and a further Rs 2,040 per classroom was allotted for M&R. Provisions for M&R are made only for schools owned by the provincial government, leaving the rented buildings and mosques that house more than 19% of all students in grades K-8 without such support. About one in six schools operates as a “shelterless school” – i.e. without a building.

2.15 The Education Department has recently initiated reforms in the budgeting process to make the demand for salary funds more realistic, using “school-based” budgeting to define the need for salaries on the basis of the actual posting of staff, rather than relying on norms and total projected enrollment. This procedure has not yet been employed, however, in determining the education budget or its allocation among schools.

Education Performance

2.16 The achievements of the elementary education system in Punjab have been disappointing. At the beginning of the 21st century, the adult literacy rate is about 46% in Punjab, and the literacy rate for women is only about 34%. Between 1992 and 2000, the period covered by the SAP, the adult literacy rate increased by no more than four percentage points. Moreover, the criterion for literacy used – a declaration that one is able to read and write – is not a reliable measure and almost certainly falls short of the level of literacy skills required in modern life.

2.17 The slow pace of progress in overcoming illiteracy is in large part due to the failure of many families to enroll their children in school. During the 1990s, the Gross Enrollment Rate (GER) fell from 80% to 75%, while the Net Enrollment rate (NER) fell from 53% to 44%.

These declines were largely induced by a reduction in enrollments in government schools during this period (GER fell from 68% to 53% and NER fell from 43% to 28% in government schools). Moreover, there are indications that the education gap between rich and poor children has been increasing over time in Punjab. Children of urban and rich rural households show significantly higher levels and also faster growth in primary school enrollment rates compared to the poorest households.

2.18 It is estimated that private schools now account for 41% of total primary and middle school enrollment in Punjab. In urban areas the proportion of enrollment in public schools has declined to the point where the majority of urban primary school children now go to non-government schools. There is no reliable information available on private schools, nor an effective certification process ensure that the quality of instruction is adequate.

2.19 The high attrition rate among children enrolled in primary schools continues to be a major problem. During the period from 1989 to 1998, the proportion of children passing from the first to the second grade has remained roughly constant at about 59%. Boys (69%) have been somewhat more successful than girls (51%), but even for boys the wastage rate (31%) is high. Moreover, of those enrolled in the first year of primary school, only half have gone on to complete four or more years of education – the generally recognized minimum for achieving lifelong basic literacy. In the case of girls the figure is only about a third.

2.20 The performance of public sector middle schools has been little better, despite far more selective enrollment. About one in five children aged 10-12 years is enrolled in a middle school, but of those who enter grade 6 only a little more than half (about 56%) complete grade 8 – half again more boys than girls. Out of every thousand children entering first grade, only 264 complete middle school. These high dropout rates imply that a large proportion of the resources devoted to basic education are not contributing to the development of sustainable literacy and numeracy skills and thus are being wasted.

2.21 Secondary education in Punjab is provided in two parts. The first two years are offered by both middle schools and high schools, while upper secondary education (the second two years) is provided at both high schools and colleges. A matriculation exam is administered at the end of the 10th year. In 1999 only 41% of public school students taking the test received a passing grade, an especially startling outcome because only about one-sixth of an age cohort reaches the 10th grade, and therefore the population presumably is already in the upper range in terms of academic performance.

Decentralization of Education Management

2.22 Of various reforms to improve the performance of Punjab's primary and secondary schools and students, the devolution of responsibility to local governments holds the greatest long-term promise. Centralized education systems have a variety of drawbacks. While much effort and expense go into gathering and analyzing system-wide data, information about local needs and priorities is rarely transmitted effectively. Moreover, the priorities of centrally managed education systems tend to be supply-driven and to reflect the preferences of senior officials. Lack of ownership of education priorities by local beneficiaries undermines accountability, because community members do not value fully the services provided by the schools and therefore do not demand good performance from them. Centrally managed education

systems rely on standardization and command-and-control strategies, thus discouraging experimentation with new approaches to learning and alternative instructional contents.

2.23 International experience suggests that transfer of authority to the local government level, as envisaged in Pakistan, can lead to improved education outcomes provided that resources are used more effectively, the local government responds more quickly to requests for teachers and supplies, and more frequent and thorough supervisory visits occur. However, decentralization within the government hierarchy alone is not sufficient, and a great deal more can be achieved if autonomy is given to schools. School effectiveness can be enhanced through the involvement of parents and the community, which can lead to better decisionmaking, greater ownership for decisions, and greater sustainability, raising quality and reducing dropouts. Pakistan has experimented in recent years with school management committees and PTAs, providing them access to and control over modest amounts of non-wage maintenance and repair (M&R) funds for each school. Although these bodies have not achieved uniform success, the importance of participation by parents and communities is widely recognized. The devolution plan provides for this, although the relationship between Citizen Community Boards (CCBs), with their broader mandates, and PTAs/SMCs needs to be clarified. Whatever the concrete arrangements, a clear message from international experience is that there needs to be an unambiguous definition of the rights and responsibilities of community groups vis-à-vis the school. Also, the availability of appropriate information for the community and its representative groups to help them make informed choices is an important factor in success.

2.24 As is demonstrated by international experience, all levels of government can continue to play important roles in education under devolution, albeit different from those in a more centralized system. The federal government can set broad guidelines for education to ensure comparability of basic qualifications and credentials, including a national core curriculum. Establishing minimum qualifications for teachers and school administrators is usually a national responsibility as well. This ensures that teachers are able to move freely among jurisdictions and that their competencies are accepted everywhere. The integrity of testing, certification, and competitive admissions processes will require high-level involvement to minimize fraud and corruption and to ensure the credibility of credentials. On the funding side, the federal government can provide financial resources to ensure that all children have access to a stipulated minimum level of education. Elaborate formulas have been adopted in many countries to equalize educational opportunities and at the same time to encourage local effort.

2.25 While the role of the federal government in basic education is fairly clear, there is greater scope for variation in the distribution of responsibilities between provincial, district, and sub-district levels of government. Some guidelines based on international experience are as follows:

- Clear definition and assignment of responsibilities is essential.
- Management of the teaching staff – recruitment, assignment, and evaluation – is the single most important function to decentralize, and decentralizing to the community or school level is most likely to lead to the best outcomes.
- The provincial Education Department needs to support the decentralized system and play new roles, such as providing public information on school performance to parents and communities, ensuring equity through special programs, providing funding targeted at the poorest districts, and building local government and school management capacity.

2.26 Other possible roles for intermediate levels of government may include specifying additional curriculum of regional or local interest, such as local languages, regional history, and

vocational content like agriculture or commerce. Provincial governments may impose additional requirements for teachers and may set standards for school buildings. They typically provide both pre-service and in-service teacher training. Lower levels of government often provide supplementary in-service training on content and on local teaching/learning needs. At the most basic level, decisions on the sequencing of curriculum, the pacing of instruction, and the choice of instructional methods are best made at the school classroom level. Ensuring that local managers have powers consistent with their being held accountable for performance is a very important element of educational decentralization.

2.27 Teacher qualifications, morale, and motivation are recognized as critical for the success of basic education. The logic of devolution argues for teachers to be treated as local government employees. This facilitates the hiring and firing of staff, increases accountability to beneficiaries, and may allow greater flexibility in setting wages, benefits, and working conditions than is possible under central or provincial government management. The change in the formal status of school teachers from provincial employees to local government employees can be phased over a period of time, however. Minimum competencies in any case should be ensured by provincial and national certification of teachers.

2.28 Decentralization will not remove all shortcomings, and it will not be a rapid process. Shifting to a much greater degree of local control over and responsibility for basic education, however, can reduce costs, make schools more responsive, strengthen accountability, boost staff morale, and encourage curriculum innovation and adaptation to local needs. It also holds the promise of mobilizing more local resources to upgrade educational quality, because citizens are more likely to support education that reflects their participation and values. At the same time, devolution carries risks related to limited local capacity for education management, the possibility of elite capture of local governments, and continuing neglect of service delivery if teachers and local education managers do not become more responsive to students and communities. These risks will be minimized if accountability mechanisms and community participation arrangements (integral elements of the devolution program) work effectively.

2.29 Many countries have announced decentralization policies only to find that they are never fully or successfully implemented. How can Punjab ensure that education decentralization is in fact carried out and works? International evidence on the implementation of education reforms, including decentralization, provides several lessons.

- First, successful implementation requires an explicit, detailed strategy that anticipates possible problems.
- Second, to implement and sustain reforms requires that commitment be built among the key stakeholders, including teachers and parents. One means of building commitment is to encourage their participation in developing the implementation strategy.
- Third, implementation can be enhanced and made more effective through a process whereby the federal and provincial governments identify successful districts and schools, ascertain why they are successful, and use that information to fine-tune policies.
- Fourth, there is no substitute for proactive top-level leadership of the reforms.

2.30 One of the most powerful tools the federal and provincial governments have to ensure that decentralization leads to better education is financing. There are concerns that the district, being a general-purpose government, may fail to fund education adequately, whereas there are sound economic reasons for ensuring that all children receive at least some minimum level of

resources for their schooling. One possible solution is a formula-based capitation grant for districts, based on the number of students and their attendance in school. Such a capitation grant would provide incentives to ensure that children enroll in school and, once enrolled, attend regularly. For particularly poor districts/sub-districts, additional support might be needed.

Conclusions

2.31 To cope with the rapid pace of technical change and the globalization of markets, Punjab must raise its very low enrollment rates in primary and middle schools and ensure that a much higher proportion of grade one students completes primary and middle school, especially girls. New approaches are needed to achieve these objectives.

2.32 The provincial government has rightly focused on improving quality, which is key to attracting and keeping more students. As mentioned earlier, however, the numerous initiatives that have been recently introduced need to be carefully assessed in relation to their cost-effectiveness. Sharply increasing and protecting allocations for non-salary expenditures will be important. The provincial government has begun to put modest amounts of such funds under the control of functioning School Management Committees (SMCs), which is promising but needs to be fully implemented along with sound financial management arrangements. Enhancing and sustaining the progress made in reducing teacher absenteeism will require community monitoring, with meaningful input by SMCs into the performance evaluation of teachers. Plans for learning assessments at grade 4 and grade 8 should be pursued further. These can be used not only to identify poor performance but also to inform teacher training and curriculum reform.

2.33 Devolution has the potential to raise the quality of education and increase enrollments and reduce dropouts, but decentralization beyond the local government to the facility level is needed to realize this potential. There needs to be strong local government financial management as well as meaningful accountability to beneficiaries and local voters. Shifting responsibility for oversight to local communities will not only provide stronger incentives for quality service delivery and greater accountability, but it will also allow communities and teachers to adapt programs to local needs and aspirations more effectively. Decentralization also carries risks and will not solve all of Punjab's primary and secondary education problems, but given the failure of highly centralized management, there is no alternative.

2.34 Strong efforts should be made to create a positive enabling environment for the private sector in education. Wise public policy on private education can help the poor as well as the better-off to gain more access to schooling. Private schools need a clear legal status and freedom from petty harassment or extortion, along with appropriate regulation to ensure adequate quality. Teachers working in private schools should be required at a minimum to have credentials similar to those of government teachers. Schools need to be licensed or certified to ensure that they are safe and that they provide a minimum core curriculum. In view of the strong demand for private education, the possibility of meeting the needs of additional students by offering state scholarships for study in private schools should be explored. Experience in Pakistan and elsewhere shows that small subsidies to private schools can leverage a large response in terms of access to schooling. Moreover, private schools produce somewhat better learning outcomes for a given level of expenditure.

3. HEALTH

Overview and Key Issues

3.1 Punjab's health indicators remain unacceptably low, and limited public sector resources for health are not being effectively utilized. Public health spending is lower than in other countries and is skewed in favor of salary costs. Doctor absenteeism is widespread, and there is excess staffing of doctors in urban areas and understaffing in remote rural areas. Government-provided medicines often are not available. Many of Punjab's basic public health units (BHUs) are attracting so few patients on any particular day that they are outnumbered by the staff (80% of outpatient contacts are with private health care providers). Preventable communicable diseases are common and very costly to the economy and society. The infant mortality rate is 95 per thousand, compared to 89 for Pakistan as a whole and much lower levels elsewhere in South Asia. Only 55% of two-year-old children were fully immunized in 1998/99. The contraceptive prevalence rate (CPR), although rising in recent years, is far below the CPR of other countries. In sum, Punjab in the health sector is failing to achieve what should be its primary objective: reducing premature mortality, morbidity, and fertility through cost-effective programs.

3.2 As in the case of education, both financial resource constraints and institutional problems contribute to these outcomes. Although Punjab has started to shift the balance of public sector health spending away from curative treatment and in favor of communicable disease control (CDC) and maternal and child health (MCH), this adjustment still has a long way to go, and expenditures on CDC and MCH remain far too low given their demonstrated very high social and economic returns. The effectiveness of health sector spending suffers from overly centralized management, the great distance of decisionmaking from beneficiaries, and lack of accountability reflected in absenteeism, pilferage and losses, etc.

3.3 The province has initiated some reforms, albeit in a fragmented manner. The initial change in the priorities of health spending in favor of CDC and MCH is promising. Decentralization measures, including a pilot program of health system "autonomy" in two districts, have been superseded by the national devolution program. Punjab has also experimented with contract employment of doctors in the interest of greater staffing flexibility. The provincial government starting in 1999 granted a much greater degree of managerial and financial autonomy to some of its tertiary public hospitals, including competitive hiring of hospital chief executive officers. Preliminary assessments indicate that gains have been made in efficiency and governance, although there are equity concerns that poor patients may be displaced.

3.4 As in the case of education, devolution opens up opportunities for improving public health services, through greater accountability of government health staff to the public, improved efficiency of resource allocation (due to better information as a result of proximity to local conditions), and partnerships and better coordination with private health services. On the other hand, it is necessary to ensure that local governments give priority to the most cost-effective services which have the potential for effecting significant improvements in the health status of the population. It is also important to ensure that poor households have adequate access to essential health services in a decentralized system.

The Burden of Disease and Health Sector Performance

3.5 In Pakistan generally (and in Punjab as well), three factors account for almost 60% of the burden of disease (measured in terms of life-years lost). Communicable infectious diseases (almost 40%), reproductive health problems (12%), and nutritional deficiencies (6%) primarily affect young children and women of reproductive age and account for a dominant share of mortality and morbidity. All three are basically preventable or readily treatable at reasonable cost, but Punjab's public health services are not preventing or treating them adequately.

3.6 On the basis of the burden of disease and cost-effectiveness considerations, top priority should be assigned to control and prevention of communicable diseases, especially those included in the Expanded Program of Immunization (EPI), tuberculosis, and HIV/AIDS. Also of top priority for the public sector are maternal and child health services, including family planning, pre- and post-natal care, deliveries by trained personnel, and management of the sick child (especially for diarrhea, acute respiratory infections, and malnutrition). Health education programs also are important because they would enable households to take better care of their own health problems. Most of these top-priority services can be delivered through first-level health care facilities linked to community-based health workers and backed by referral services in secondary hospitals at the Tehsil and District Headquarters levels.

3.7 Public health in Pakistan and in Punjab has improved during the past three decades, but the pace of improvement has not been satisfactory. Misplaced priorities and the uneven quality of health services have contributed to these outcomes, but other factors, including poverty, low levels of education, and inadequate water supply and sanitation, have also been very important.

3.8 **EPI.** The percentage of fully immunized children 12-23 months old in Punjab in 1998/99 (the latest year for which province-wide survey estimates are available) was 55%. Although better than the national average of 49%, this figure is still far too low. In 1999 the Punjab Health Department launched a campaign to expand immunization coverage, but this increased level of effort was not sustained.

3.9 **Tuberculosis Control.** Tuberculosis is a major health concern in Pakistan, where point prevalence is estimated at about 260 cases per 100,000 population, of which about two-thirds are contagious cases. This implies that Punjab currently has some 190,000 TB cases. Initially in one district, Punjab is starting to implement a new program to provide treatment of TB patients with the DOTS methodology recommended by WHO. Rs 2.8 million has been provided for this program in 1990/00, in addition to Rs 50 million earmarked for TB drugs. This is a promising beginning, but there is a long way to go to achieve an effective province-wide tuberculosis control program, and substantial additional resources will be required.¹

3.10 **HIV/AIDS.** While the prevalence of HIV infection in Pakistan appears to be low at present, it is certain to increase, and HIV/AIDS poses an enormous risk to the country. Punjab has been slow to react to this public health threat, initially relying solely on the small amount of resources provided by the federal government. A provincial PC-1 (the form necessary to initiate

¹Assuming that existing staff can implement the program, treatment cost per case using the DOTS approach is estimated at Rs 3,000 – Rs 2,300 for drugs, Rs 300 for lab services, and Rs 400 for monitoring and supervision. The total non-salary cost of treating all current tuberculosis victims in the province would be around Rs 570 million.

a development activity) for the HIV/AIDS program has only recently been approved. Moreover, it provides for only a very small amount – Rs 5 million over three years.

3.11 Nutrition and Health Education. There are no nutrition or health education programs in Punjab. PC-1s for both are under preparation but not yet approved.

3.12 Family Planning Services. Punjab has made good progress in expanding family planning services, with about 90% of government health facilities reporting their provision. However, irregular supply of contraceptives from the federal Population Welfare Ministry continues to constrain contraceptive choices. The percentage of currently married women using contraceptives in Punjab in 1998/99 was 28% in urban areas but only 16% in rural areas.

3.13 Reproductive Health. Punjab in the past several years has increased the number of female paramedical staff, the key cadre for provision of ante-natal and post-natal care, in government health facilities. Eighty five percent of BHUs now have at least one female paramedical staff. Nevertheless, the situation concerning maternal care remains problematic; nearly a third of all births were not attended by any health care provider (at home or in a medical facility) according to the 1998/99 PIHS. Moreover, only a third of pregnant women in Punjab (58% in urban areas, 25% in rural areas) visit a health facility for pre-natal consultations, and only 10% do so for post-natal consultations. While these low figures are explained in part by demand-side constraints, they point to the need for more energetic health education campaigns and for training of larger numbers of midwives.

3.14 Care of Young Children. Performance in this area needs much improvement, given the very high infant mortality rate in Punjab. In addition to the province's failure to achieve satisfactory immunization coverage, clinical care of seriously ill children needs to be improved. Efforts to introduce the Integrated Management of Child Illnesses (IMCI) methodologies currently recommended by WHO and UNICEF are at an early stage.

3.15 Curative Health Care. Punjab's curative public health system, comprising 2,400 BHUs, 287 rural health centers (5,400 beds), and 89 tehsil and district headquarters hospitals (8,200 beds), has been ineffective. The sick frequently do not visit these facilities, as doctors officially posted there are often absent and government-supplied medicines often are pilfered. To fill the vacuum left by the inadequacy of public health facilities, there has been a sharp increase in private sector health providers. This development is not reassuring, since many private providers lack formal medical training, and the quality of private care in general is uneven.

3.16 Private Sector Regulation. In the past two years, the provincial government has made commendable efforts, including deployment of 100 new drug inspectors, to improve the quality of pharmaceuticals sold in the province. A law has also been promulgated regulating blood banks in both the public and private sectors, and drug inspectors have been assigned the additional responsibility of monitoring compliance with this law. While these initiatives are welcome, the key need is to implement effective regulation of the private sector without harassment. There is also much scope for developing various types of partnerships between the public and private sectors that would lead to more effective private health care services.

Health Sector Budget and Budgeting

3.17 Punjab's total budget allocation for health in 1998/99 was Rs 8,173 million (Table 3.1), or about Rs 113 per capita, based on the estimated 1998 population of 72.5 million. Actual expenditure in 1998/99, however, was only about 73% of the budget allocation, i.e. Rs 5,932 million, implying a per-capita expenditure of Rs 82 or about US\$1.64. Two other components also contribute to total government expenditures on health services. First, there is Foreign Project Assistance (FPA) – the foreign-aided portion of certain projects that is paid for directly from “assignment accounts”. In 1998/99, disbursements from these accounts for health projects in Punjab probably totaled around US\$4 million, or about Rs 200 million. Second, the federal government funds some health services such as family planning that benefit the population of the entire country. Assuming that 55% of this federal expenditure benefits Punjab directly (based on the province's share in total national population), it would add about Rs 3 billion to public spending for the province in the health field.

3.18 Total actual outlays would thus be around Rs 9.1 billion in 1998/99, or about Rs 126 per capita (US\$2.50), equivalent to about 0.5% of provincial GDP. This figure is very low by international standards. A World Bank study of twelve mostly low-income Asian countries in the late 1980s found that government health expenditures on average were equivalent to 1.3% of GDP; the average for all low and middle income countries is about 2% of GDP.

3.19 In 1998/99, out of total actual expenditures by the provincial Health Department, 43% went to the SAP component of government health services, primary health care, and Tehsil Headquarters Hospitals. Adding spending on District Headquarters Hospitals (since their functions are often similar to those of Tehsil Headquarters Hospitals), the proportion of total health expenditure going to primary and secondary health care in 1998/99 was about 57%. The remaining 43% went to teaching hospitals and other tertiary and specialty hospitals, medical education, and other miscellaneous expenditures including administration. Although the broad allocation of resources for public health thus is not distorted in favor of tertiary care, greater emphasis on the priorities referred to above would further increase the share of primary and secondary care and thereby improve the composition and quality of health expenditures.

3.20 In terms of the economic or object classification of expenditures, actual non-salary expenditure in 1998/99 – Rs 1,631 million – took up 32.7% of total current spending of Rs 4,984 million (Table 3.1). As discussed below, the Punjab Health Department employs too large a staff for its current workload. At the same time, there is evidence that allocations for some non-salary inputs are insufficient. More efficient allocation across object categories would imply a higher non-salary/salary spending ratio than at present. It should be noted that in the non-SAP portion of the Punjab health budget, budgetary grants to hospitals that have been made autonomous are now classified as transfers and hence as non-salary allocations. This explains why the non-salary share of the 1999/00 budget increased very sharply, but in reality these transfers are in large part funding salary expenditures of the autonomous hospitals.

3.21 Table 3.1 also shows a large shortfall of actual health spending relative to budgets for both SAP and non-SAP categories in 1998/99, but much larger for the SAP component. Actual SAP expenditure was only 62% of the budget allocation, compared to 84% for non-SAP. Shortfalls in salary spending are attributable in large part to budgeting for many posts that remain vacant throughout the year, and for salary adjustments that may not occur. Part of the reason that many vacancies persist is the periodic imposition of recruitment bans. In March-

April 2000, for instance, there was a ban on recruitment of all categories of health staff except for medical officers and Lady Health Visitors.

**Table 3.1: PUNJAB HEALTH BUDGET AND EXPENDITURE
1998/99 AND 1999/00
(Rs Million)**

	1998/99 BE	1998/99 Actual	Ratio Actual to Budget (%)	1999/00 BE
SAP:		Exp. (est.) b/	1998/99	
Current Budget:				
Salary	2,425	1,459	60%	2,530
Non-Salary	1,142	688	60%	1,401
Total SAP Current	3,567	2,147	60%	3,931
Development Budget	550	389	71%	461
Sub-total SAP	4,117	2,536	62%	4,392
NON-SAP:				
Current Budget:				
Salary	2,321	1,894	82%	1,680
Non-Salary	1,156	943	82%	1,890
Total Non-SAP Current	3,477	2,837	82%	3,570
Development Budget	579	559	97%	825
Sub-total Non-SAP	4,056	3,396	84%	4,395
Total Health a/	8,173	5,932	73%	8,787
Of which Current	7,044	4,984	71%	7,501
-Salary	4,746	3,353	71%	4,210
- Non Salary	2,298	1,631	71%	3,291
Of which Development	1,129	948	84%	1,286

a/ Excluding FPA.

b/ Figures on 1998/99 actual expenditure were reported to the mission by the Health Department, based on Monthly Civil Accounts, June final, AG Punjab.

[Note: Data from the Finance Department, reportedly based on the 1998/99 Appropriation Accounts, shows a higher figure for total actual expenditure of Rs 7,110 million instead of Rs 5,932 million].

3.22 Anecdotal evidence suggests that resources for non-salary recurrent inputs for health services are grossly insufficient throughout Pakistan. Government health facilities routinely run out of medicines and other supplies, and it is commonplace for their patients to be asked to purchase various items from private outlets. Moreover, regular Health Management Information System reports show that supplies of essential drugs for primary health care facilities have been exhausted. In Punjab in the last quarter of 1999, half of the primary health care facilities reported that supplies of at least three essential drugs had been completely used up. Supervisors at many levels complain of not having funds to operate their vehicles (and often of not having any vehicles), and hence being unable to perform required field visits. Hospital managers report that funds for repairs and maintenance are insufficient. Payments of utility bills incurred by hospitals and other health facilities get delayed. Of course, even if budgeted resources were fully

used, many facilities would still lack the funds to provide adequate care, especially for outpatients. Shortfalls in non-salary expenditures in relation to the limited allocations are due to late releases of budgeted funds, ad-hoc austerity restrictions on purchases (e.g. purchases of vehicles and other durable goods), across-the-board economy cuts (10% in 1999/00 for non-SAP spending), and tightened accountability measures that reportedly have made many government officers reluctant to spend funds from their budgets.

The Scope for Greater Efficiency Through Better Management

3.23 The severe shortage of public sector resources highlights the need to use available funds more efficiently, and there are several options for doing so. A 1998 World Bank report, some of whose findings are summarized in Table 3.2, found wide gaps between actual and “normative” variable unit costs at all four public health care levels. These gaps could be reduced significantly if government health facilities would use generic as opposed to branded drugs whenever generics are available, and if lists of essential drugs now in use are further narrowed.

3.24 Another problem is that facilities are under-utilized, with very low bed-occupancy rates – 19% for rural health centers, 35% for Tehsil Headquarters Hospitals, and 34% for District Headquarters Hospitals – compared to the level of 80% generally considered necessary for efficiency. Based on a 1998 study, doctors saw between nine and 16 outpatients a day, not even half the OECD average of 30-40 consultations.

Table 3.2: ESTIMATED ACTUAL AND NORMATIVE VARIABLE UNIT COSTS FOR OUTPATIENTS AND INPATIENTS IN FOUR TYPES OF GOVERNMENT FACILITIES

In Rs at 1996 prices

	Basic Health Units	Rural Health Centers	Tehsil HQs Hospitals	District HQs Hospitals
i. Actual Variable Cost per Outpatient Contact	5.9	14.2	17.3	15.0
ii. Normative Variable Cost per Outpatient Contact	58.0	58.0	146.0	146.0
iii. Actual Variable Cost per Inpatient Admission		66.0	438.0	585.0
iv. Normative Variable Cost per Inpatient Admission		164.0	661.0	616.0

Source: "Pakistan – Towards a Health Sector Strategy", World Bank, 1998.

3.25 Excessive numbers of unskilled staff and of general duty medical officers in grades 17-18 inflate payrolls. Out of a total of 73,186 posts in the 1999/00 current budget of the Punjab Health Department, 22,562 (31%) are in the lowest grade, i.e. Grade 1, and 30,308 (41%) are in the lowest four grades. These staff work as ward servants, chowkidars, sweepers, gardeners, cooks, and general laborers, and it is unlikely that so many of them are needed. Out of almost 10,000 posts in grades 17 and 18, the bulk are held by general duty medical officers and dentists, whose numbers seem excessive in relation to current patient workloads. Finally, administrative costs, which should be held close to 5%, also are too high – 9.1% of the 1999/00 budget – and staff absenteeism and pilferage of medicines further detract from efficient operations.

3.26 Inefficiency hinders the delivery of health care services not only in hospitals and BHUs, but at the top of the organization as well. Inadequately paid and qualified personnel, for instance, are unable to supply needed skills for program planning, monitoring and evaluation (M&E), and policy formulation. This deficiency intensifies the harm done by over-centralized

planning and management at the provincial headquarters level. The recent initiative in Punjab to grant much greater managerial and financial autonomy to tertiary hospitals and their associated medical colleges is a good step toward decentralization. The absence of a well-thought-out policy framework on the financing side, however, is a cause for concern.

3.27 Although considerable resources have been spent on developing a Health Management Information System (HMIS), the data it generates are not being used by managers to assess results on the ground, and managers are not holding staff accountable for unsatisfactory performance based on such assessments. This perpetuates poor incentives for service delivery. Greater attention to results on the ground, especially for key programs such as EPI and tuberculosis control, would require a stronger information system. The HMIS needs to be complemented with survey-based instruments for data collection. At present, the only such instrument is the PIHS, conducted every two years. Smaller periodic surveys could yield district-level estimates of EPI coverage and provide guidance to managers to focus on districts with the lowest coverage rates.

Cost Recovery

3.28 Government health facilities in Punjab charge small amounts per outpatient consultation and per inpatient admission and collect additional charges for diagnostics (x-rays, laboratory tests, electrocardiograms, etc.). When available, drugs are usually provided free of charge. Many hospitals also operate upscale “private wards”, where charges are much higher. The proceeds from all user charges – Rs 250 million in 1998/99, only 4.2% of the department’s total expenditure in that year – accrue to the provincial Treasury, except for those of hospitals granted autonomous status. Government medical colleges charge small fees for tuition. It should be noted, however, that cost sharing in relation to government health services is much higher than the above cost-recovery percentage would indicate. This is because it is common practice for patients to purchase required drugs and other medical supplies from commercial outlets. For hospitalized patients, relatives often provide food and carry out many tasks that in developed countries would be handled by nursing staff.

3.29 Initial experience with autonomous hospitals demonstrates that there is potential for increasing cost recovery for government health services, but if user charges are increased, there needs to be careful monitoring and provisions to offset any adverse effects on poor households. In rural areas, with relatively few private doctors, increases in user charges in government facilities would tend to raise the proportion of rural people using untrained private practitioners – an undesirable result. To avoid driving poor patients away, government facilities should seek to upgrade the quality of their services as they raise user charges – on the model of the autonomous hospitals. In sum, any large-scale attempts to increase cost recovery would need to take place in the context of a more comprehensive reform of government health services, including monitoring of the effects on poor households.

3.30 In priority public health areas, Punjab should ensure that the prevention and treatment of tuberculosis and other communicable diseases are provided free of charge in government facilities. The government may even want to subsidize treatment of these diseases by private practitioners as part of a comprehensive tuberculosis control program. Such subsidies should be part of a package that also includes training and monitoring of participating private doctors.

Devolution and the Health Sector

3.31 For the health sector as for many other sectors, Pakistan's devolution program is potentially the most important reform in many years. This initiative, which will be implemented in 2001/02, would imply a partial shift of responsibility for basic health services, up to and including the first level of referral, from the provincial governments to the newly-created district governments. If successfully implemented and sustained, devolution could have major benefits for the health sector. It could strengthen the accountability of government health staff to the public. There is also potential to improve the efficiency of resource allocation within the health sector, as a result of local public sector managers' better knowledge of local conditions. And devolution could open up greater scope for experimentation leading to more effective service delivery, for example through contracting out services and other forms of partnerships with the private sector.

3.32 A major challenge will be to ensure that local governments give priority to public health services which are cost-effective and potentially can bring about large improvements in the health status of the population, including poor households – services such as immunization, other forms of communicable disease control, maternal and child health, and family planning.

3.33 Some principles/guidelines relevant for devolution in the health sector have emerged from the experience of other countries, including the following:

- It is critical that “the center” – in this case the provincial government – has an adequate information system for tracking the evolution of reforms and results on the ground. Quantity of services, composition, and quality need to be monitored. In addition to maintaining the existing Health Management Information System, it would be useful to carry out district surveys.²
- In order to make intelligent use of the information gathered, the provincial government would need to create and staff a competent policy, monitoring, and evaluation unit.
- It is also critical that the provincial government has the capacity and resources to provide technical assistance to the local governments (e.g. for preparation of annual operational plans, budgeting, and quality control of key programs such as tuberculosis control).
- There will be a great need for building management capacity at the district level and below.
- In order to ensure that national priorities such as immunization are fully implemented by local governments, it will most likely be necessary for the province to provide tied grants (perhaps as matching grants) to encourage local governments to pursue these priorities and provide the services concerned.

Concluding Recommendations

3.34 Given Punjab's high rates of fertility, infant and child mortality, and maternal mortality, top priority should be assigned to an attack on preventable and readily treatable diseases that primarily affect young children and women of reproductive age and account for a dominant share of mortality and morbidity. This will require higher-quality health services that are widely and equitably accessible. Financing such services requires not only higher levels of expenditure but also a more rational allocation of spending – lower budgets for salaries and more efficient,

² Trends in PIHS data, which give information at the provincial level, could mask divergent trends across districts in a province.

predictable spending on non-salary components. If cost recovery is to be emphasized and user fees raised, there needs to be careful monitoring of the use of services by the poor, and provisions to ensure that their access to services does not decline.

3.35 Some specific recommendations for reforms to improve the effectiveness of Punjab's public sector health system, in the context of devolution, are outlined below:

- **Give top priority to control of communicable diseases**, especially EPI, tuberculosis control, and HIV/AIDS prevention; and to maternal and child health services including family planning, pre- and post-natal care, deliveries by trained personnel, and management of the sick child, especially for diarrhea, acute respiratory infections, and malnutrition. In addition, high priority should be given to the development of safe water supply and sanitation, which will make a real difference in improving key public health indicators.
- **Health education programs should also be emphasized** to enable households to take better care of their own health problems.
- **Services for the prevention and treatment of tuberculosis and other communicable diseases should be provided free of charge in government facilities.** The provincial government should also consider providing subsidies for treatment of these diseases by private practitioners, as part of a package that also includes training and monitoring.
- **Contracting out services and partnerships with the private sector**, with adequate quality control including through training, should be actively explored.
- In health care finance, **reduce the shortfall of actual expenditure relative to budget estimates**, and release the non-salary budget in a more timely fashion.
- **Remove low-priority vacant posts** from the budget, and eliminate excessive restrictions on the ability of line departments to re-appropriate funds among budget categories.
- **Procure generic drugs whenever possible.**
- **Systematically examine the workloads of government health facilities with a view to closing those that are most lightly utilized.**
- **Reduce the numbers of unskilled staff in grades 1-4, and of general duty medical officers.**
- **Reduce unnecessary and excessive administrative expenses.**

4. AGRICULTURE AND IRRIGATION

Overview

4.1 Despite steady urbanization, agriculture still accounts for 25% of Punjab's GDP, 47% of total employment, and nearly 75% of the poor. It remains the single most important sector in the province's economy and plays a dominant role in national agricultural production. Punjab produces about three-quarters of Pakistan's basic staple (wheat) and industrial fiber (cotton), close of half of its rice, and around two-thirds of the country's fruits and vegetables, giving it the lion's share in national food security, nutrition, and agricultural export earnings. Agricultural growth is, therefore, critical for overall economic growth and poverty reduction in Punjab as well as in Pakistan as a whole, but at 3-4% p.a. since the 1970s, Punjab's agricultural growth has fallen short of its potential. This has been due to weaknesses in irrigation infrastructure and delivery, to remaining distortionary trade and pricing policies (despite major improvements in this area), to the relative neglect of non-crop activities such as livestock and fisheries, and to the ineffectiveness of government's research and extension activities.

4.2 Punjab's vast and aging irrigation system is in a bad state of repair. The irrigation deficit – measured in crude financial terms by the gap between O&M requirements and actual expenditures – is estimated at 30-40%. Despite substantial increases in irrigation water charges, they cover only about 35% of total O&M costs. Centralized and inefficient management of the irrigation system by the overstuffed Punjab Irrigation Department (PID) has resulted in delivery inefficiencies (only 35-40% of available supplies reach the fields), inequities in water availability (in particular shortages at the points farthest from canal heads), and waterlogging and salinity which ruin large areas of productive land. PID suffers from massive overstaffing – about 50% of its total workforce of 52,500 – and inadequate skills. Agricultural research and extension have not been very effective in promoting development and diffusion of new technologies, expanding utilization of modern inputs with effective quality control, or protecting against pests like the cotton curl leaf virus.

Irrigation Failures and Reform

4.3 This chapter focuses first on Punjab's irrigation system and the bold reforms that are needed and are beginning to get underway to restructure institutions, improve management, and increase funding on a sustainable basis. The lifeline of Punjab's agriculture, the provincial irrigation infrastructure has seriously deteriorated, and there is a large backlog of deferred maintenance. While drains and distributary canals are the worst affected, important structures including link canals and barrages also are showing signs of distress. Contributing factors include highly centralized and inefficient public sector management of irrigation systems, governance problems in the allocation of irrigation water, underpricing of water and low cost recovery, and inadequate funds for routine and preventive maintenance and major repairs. In fact, more than 50% of available O&M resources are pre-empted by electricity bills and the establishment cost of public sector tubewells.

4.4 The provincial Department of Irrigation and Power (PID) is responsible for irrigation management. Claiming 50-60% of Punjab's agriculture sector allocation – averaging Rs 3.6

billion annually during 1990/91-1997/98 and increasing to over Rs 5 billion in 2000/01 – PID is supposed to operate, manage, and maintain Punjab's vast network of canals, tubewells, and drains, and also to assess water rates that are collected by the revenue department. The bulk of its expenditures are for maintaining and operating tubewells (50-55%) and canals (30-35%). Establishment costs (20-30% for tubewells, 60-70% for canals) divert major amounts of funds from routine maintenance and preventive repairs and rehabilitation of infrastructure. More than Rs 300 million is spent each year only on the staff costs related to assessment of water charges, not including the costs incurred by the revenue department for actual collection of water charges.

4.5 The gap between O&M requirements and actual expenditure is roughly 30-40%. Often maintenance also suffers because of procedural delays in contracting and contractors' delays in mobilization. Annual water rate collections have doubled in the last ten years to about Rs 1,700 million, but this represents little growth in real terms. Moreover, collections cover only about 35% of total O&M costs, so there is a sizable net subsidy by the government. Collections are low due to very low water rates and collection inefficiencies. During 1999/00, less than 70% of the current year's dues and 23% of arrears from earlier years were collected.

4.6 To address these institutional and financial problems, the Punjab government has initiated major reforms as part of a national program of irrigation sector reform. The main thrust is to create a decentralized, participatory, and fiscally sustainable institutional framework in which a substantially downsized PID retains responsibility for formulating sector policy, regulatory, and general oversight functions. An autonomous Punjab Irrigation and Drainage Authority (PIDA) is to operate and maintain the portion of the canal system above the barrages, while Area Water Boards (AWBs) will operate commercially at canal commands, and participatory Farmers Organizations (FOs) will manage distribution to water users. Elected by the beneficiaries, the FOs will be responsible for assessing and collecting water charges and for operating and maintaining the distributary and minor channels in their respective jurisdictions. FOs will retain 40% of the water charges they collect to meet expenses, while the AWBs and PIDA will apply the remaining 60% toward the cost of operating the system at the canal command and above the barrages. This drastic reform aims to create incentives for the system to operate efficiently, as users directly see the benefits of their own spending in the form of better maintenance.

4.7 The legal framework for the new entities has been enacted, and the PIDA, one AWB, and several FOs have been established. Full implementation of the core institutional and policy reforms will require concerted efforts over a long period of time. Continued government commitment and diligent change management during the transition from PID to PIDA/AWB/FOs will be prerequisites for the success of the reforms. However, the most critical factor during implementation would be the establishment and fostering of a "critical mass" of FOs.

4.8 PIDA had earlier prepared a business plan for the next three years, containing illustrative financial projections based on the principles of program budgeting and optimization of maintenance resources and performance goals. The projections target the following: (i) annual savings of about Rs 850-900 million, equivalent to some 20% of PID's current budget; (ii) tripling annual collection of water charges to about Rs 3,250 million; and (iii) reducing current staffing of 52,500 by 50%. (Some of the redundant workers may be absorbed by the FOs.) While PIDA initially made a good start by devolving O&M and revenue collection responsibilities to three FOs, the overall pace of implementation has been slow, reflecting in

large part slow behavioral and cultural change in PID. PIDA needs to accelerate its efforts to mobilize and build the capacity of FOs and to operationalize the AWBs.

4.9 Privatizing remaining government tubewells in fresh groundwater areas will greatly reduce O&M costs. While over 60% of public sector tubewells have already been closed or handed over to FOs, resulting in a reduction of about Rs 1 billion in annual O&M costs, the establishment costs associated with these tubewells still need to be rationalized. PIDA needs to privatize the remaining 2,000 public sector tubewells designated for privatization and expedite the retrenchment of staff who are already redundant due to privatization of tubewells, as well as those who will become redundant as the reforms proceed. The resulting savings can be allocated for meeting O&M requirements of canals and drains as well as critical structures.

Improving Agricultural Support Services

4.10 Agricultural research and extension services have not been very effective. Despite the use of high-yielding varieties and high doses of fertilizer, average yields of the major field crops (except for wheat and cotton) have only moderately increased since the mid-1970s. Yield gaps – the difference between the highest potential yields and average yields – range between 30-50% for most crops. The failure to realize the potential for productivity enhancements can be attributed to:

- deficiencies in generating and diffusing improved production technologies;
- depletion of soil nutrients, unbalanced use of nutrients, inadequate and untimely water availability, secondary salinity in the irrigated areas, and poor quality of seeds, fertilizer, and pesticides; and
- lower cultivation intensity on the substantial proportion of arable land held by large landowners.

4.11 Another negative factor is the focus of sector development strategies primarily on crop production, with less attention to high-potential non-crop sub-sectors, especially livestock and fisheries. Moreover, too little has been done to enhance the linkages and complementarities between agriculture and other rural/non-rural sectors. For example, farmers can grow grain and raise livestock simultaneously because their busy periods occur at different times of the year.

4.12 Some distortionary government interventions in agricultural input and output pricing and marketing have recently been withdrawn. Remaining significant agricultural subsidies include subsidies on wheat sales to flour mills, land development equipment rental/services, and irrigation water. Apart from skewing incentives and resource allocation, these subsidies impose a financial burden, and the provincial government is planning to substantially reduce them and/or phase them out.

4.13 Perhaps most important, public sector institutions have dominated the provision of agricultural support services. The centralized bureaucracies responsible for delivering these services have not provided an adequate interface of public, private, and beneficiary activities. They have become overextended, ineffectively providing a range of private as well as public goods and services. Despite some recent improvements, public sector policies, institutions, and expenditures continue to be ineffective to a large extent. There are few financial incentives to encourage research workers to develop varieties suited to local soils and climates. Extension workers are underpaid and demoralized. Insufficient funds are provided for their visits to

villages, and nothing links the results they achieve on the ground to their earnings. The more competent workers usually prefer to stay away from the field, opting for postings in administrative and managerial positions in large cities. Normally, those who visit villages respond mainly to the needs of the more affluent and influential farmers.

4.14 The key agencies charged with providing agricultural support services are PID and the Provincial Departments of Agriculture, Livestock and Dairy Development, and Fisheries. In addition, the Punjab Agricultural Research Board (PARB) and Punjab Seed Corporation (PSC), both autonomous bodies, play a role, as does the Water Wing of the federal Water and Power Development Authority (WAPDA) in matters relating to inter-provincial irrigation and drainage issues. WAPDA's Power Wing provides electricity to irrigation tube wells.

4.15 The transformation of agricultural development in the post-Green Revolution period and the forces shaping global trade in agricultural commodities require major adjustments in the outlook, organization, and operations of these agencies. Both sets of changes have significantly altered the technical, social, and economic environment for agriculture and for delivering agricultural support services. For example, increasing globalization of trading systems requires that agricultural production and marketing systems be closely linked with domestic and international markets. Technology needs dictate more knowledge- and skills-intensive agricultural production and farming systems, intensification of existing crop production technologies and cropping practices, and production of higher-value crops, livestock, and fish. Programming of agricultural research and extension needs to take full cognizance of these imperatives and to be demand-driven and flexible in order to cater to the varying needs of farmers in different agro-ecological zones and in varying demographic settings. Tightening domestic resource constraints, a rapidly changing public/private interface, and efficiency, sustainability and equity concerns require that delivery of agricultural support services be rigorously prioritized and organized as decentralized, participatory, gender-sensitive, and pro-poor operations. Research and extension interventions need to focus on services that the private market cannot provide because the benefits are not captured by individual users.

4.16 The structure, programs, and operations of the Department of Agriculture (DA) have been slow to adjust to the new realities. Research and extension programming, for example, has been largely a top-down exercise carried out by a large number of field staff who are poorly equipped professionally and materially and inadequately supervised. Research programming is primarily the product of the researchers' own perception of priorities, linked coincidentally if at all with the beneficiaries, extension staff, and other agencies. The provincial apex research agency, PARB, has not been functioning effectively. Extension and research accounts for nearly half of the DA's total expenditure, but the bulk of these funds go to salaries and wages, leaving little to cover the operational costs of extension and research programs. A start was made in rectifying this imbalance in 2000/01, especially in the case of extension.

4.17 Although research and extension are likely to remain publicly provided in the near future, it should be possible to make their delivery more demand-driven and participatory. The DA has made a start in this direction by shifting to a strategy for provision of agricultural extension services based on village-level training and extensive interactions with and advice for individual farmers. This new approach needs to be carefully evaluated. It should also be possible to pursue partnerships with NGOs, CBOs, universities, and private sector institutions.

4.18 DA land development activities benefit only a small number of farmers (probably those who are better-off), at high cost to the public. During 1994/95-1998/99, total yearly operating costs for land development programs were Rs 2,196 million, defrayed by only about Rs 672 million in income. Yet these services can be profitably provided by the private sector, as can floriculture operations to maintain government gardens and assist urban garden lovers. The DA should also transfer responsibility for financial and administrative control of market committees, management of agricultural markets, and holding of Itwar bazaars to local governments and/or service agencies. There is a potential for saving Rs 500-550 million annually by rationalizing land development and these other activities, which could be more effectively used to improve core DA services like extension, research, water management, and program planning.

4.19 The DA's medium-term priority needs to be management reforms and not necessarily obtaining higher overall allocations from the provincial budget. Building on current initiatives, the DA needs to take on the following challenges:

- further reducing the budgetary imbalances between establishment and operating costs and between recurrent and development expenditures;
- divesting remaining activities that are clearly not public goods and services;
- moving toward partnerships and/or contracting for delivering DA's core support services;
- further developing program- and performance-based budgets; and
- assessing manpower needs (numbers and skill-mix) in light of refocused/redefined DA work priorities and formulating a realistic and coherent staffing plan.

4.20 Livestock (large and small ruminants and poultry) comprises a relatively neglected area of public sector activities and expenditures in Punjab. An important contributor to provincial agricultural GDP (about 35%) and to national exports, this subsector has the potential to significantly increase the cash incomes of the landless and the poor. Its share of budgetary allocations for agriculture, however, has averaged only about 5% during most of the 1990s. Nearly 86% of funding, moreover, went to current expenditures, 70% of it for salaries and wages. The direction and effectiveness of this expenditure is as much a concern as its total amount. The Punjab Department of Livestock and Dairy Development owns and runs 18 cattle farms and also grows fodder and food crops. Expenses of managing these farms take up more than 30% of livestock-related expenditure. Another 40% goes to veterinary research, education, and veterinary services for disease control. Only about 15% – a wholly inadequate share – goes to animal husbandry/production extension,¹ although increasing production through better nutrition and husbandry practices is equally, if not more important than disease control.

4.21 Veterinary and animal breeding services are prime candidates for privatization. The demand for preventive and curative health services is particularly strong from the owners of large animals and, to some extent, small ruminants. Many retired veterinarians have gone into private practice, and most of those still in the Livestock Department take private clients after office hours. Given the right policies and technical support, breed improvement measures – not inherently public goods and services – could be provided by private practitioners. Setting up an autonomous body for this purpose, which the Department has been considering, is probably not the right approach. Experiences have shown that such bodies tend to remain dependent on the government for their funding and also create contingent liabilities (e.g. pension obligations,

¹ Animal husbandry services are largely concentrated on breed improvement through a highly subsidized artificial insemination (AI) program. Each artificial insemination costs Rs 115, but the beneficiary is charged only Rs 20 (including follow-ups).

commercial borrowings). A more promising approach would be to create an incentives package that would move the Department's professional and technical staff into full-time private practice. For example, training and seed money (for drugs, medicines, vaccines, equipment, etc.) could launch private veterinary practices and retailing of animal drugs and medicines. In any case, the Livestock Department has no business owning 69,000 acres of cattle farms. Selling them and/or leasing them out would free up some Rs 100-140 million to invest in other priority areas, such as research and feed and fodder development.

4.22 Finally, as noted earlier support services for both crop and livestock development need to be decentralized and increasingly carried out in partnership with the beneficiaries and relevant non-government entities. This would create incentives for the government to provide services that are actually in demand. For example, the Punjab Rural Support Program and the National Rural Support Program have initiated a program for social mobilization in 12 Union Councils to integrate delivery of various services. In each Union Council, professional staff from the relevant line agencies, including those in the agriculture sector, will work as a team to deliver services. This interesting pilot program is worth trying out on a wider scale.

Conclusions

4.23 To summarize the recommendations in this chapter, Punjab's agriculture-related public sector agencies need to become much more effective in promoting agricultural development. This will require a combination of financial and institutional reforms and decentralization and privatization. Additional public funding may also be needed in some areas, but only on the precondition that existing resources are being well-utilized and focused on core public goods, that provision of non-public goods is being shifted to the private sector over time, and that there is adequate cost recovery. A number of programs can be discontinued, privatized, or performed in partnership with beneficiary groups and entities outside government. Reducing the disproportionately high share of establishment costs in current spending on agricultural support services, as is already envisaged in the case of irrigation, will be very important in enhancing the effectiveness of public spending and improving service delivery.

4.24 There is already an elaborate institutional design for reform in the irrigation sector. Although implementation has begun, progress has been slow and needs to be accelerated. Efforts at mobilization and capacity building for Farmers' Organizations and operationalizing the existing Area Water Board will be critical for moving forward with implementation on a pilot basis. This in turn will set the stage for province-wide establishment of the new institutional structure. Thorough restructuring and downsizing of PID are needed, sooner rather than later, to provide space for the new irrigation institutions to flourish.

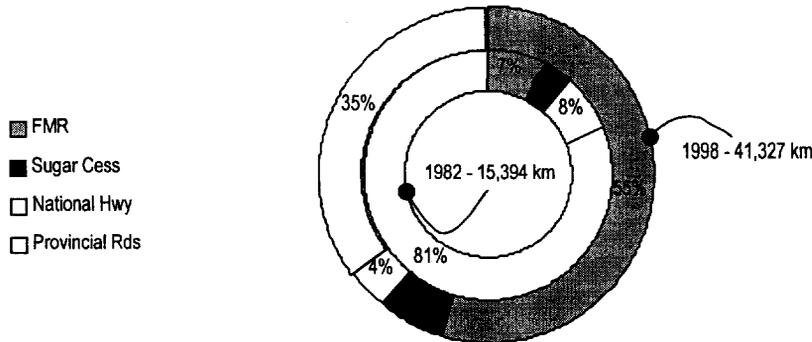
4.25 In the case of agricultural research and extension, reform plans are less advanced, but nevertheless the desirable direction of change is clear. The basic approach of decentralized management with beneficiary participation in service delivery and funding, which forms the essence of irrigation sector reforms, should be applicable for these services as well.

5. ROADS

Overview

5.1 The road sector in Punjab faces serious problems which are similar to those faced in other provinces. The province has an overextended, rapidly deteriorating road network, most of it already in substandard condition, and parts of which are uneconomic. There are currently 39,390 km of various types of roads (not including national highways and local government roads) – more than 95% of them paved. The road network has grown at a rate of 6.7% p.a. in the last fifteen years to reach a total value of Rs 120 billion (including land value). Farm-to-market roads (FMRs), currently with a total length of 21,459 km, have seen the fastest growth during this period (see Figure 5.1). According to the provincial Communication and Works Department (CWD), there is a black-top road within two kilometers of nearly every village in Punjab. The road density (km of road per square km of land area) in southern Punjab is about 75% of that in north Punjab (not a large disparity).

Figure 5.1 GROWTH OF ROADS IN VARIOUS CATEGORIES BETWEEN 1982 AND 1998



5.2 Such a large road network requires very substantial spending on maintenance and repairs (M&R) to keep it in good shape, whereas actual spending amounts to only about Rs 2 billion per year (despite recent significant increases). Chronic underspending on M&R imposes extra costs on the private sector due to much higher vehicle operating costs and wear and tear, estimated at Rs 8-9 billion per year. If not addressed through a combination of network rationalization and better funding of M&R, the road deficit and its cost to the economy will progressively increase over time. Low road user charges – amounting to less than half of actual spending and a much lower percentage of required spending – are the main factor behind inadequate road spending.

5.3 Funding is only part of the story, however. Failure to enforce limits on truck axle weights accelerates road deterioration. Punjab's road sector also has suffered from institutional fragmentation, with several agencies having been responsible for managing roads and lack of coordination among them. Selection of new road projects has not been based on explicit prioritization under an overall sector plan. Spreading funds too thinly across an excessive number of projects has resulted in a large portfolio of unfinished road projects – representing more than six years of investment at present levels. CWD, the main agency responsible for roads, is overstaffed but lacks qualified and skilled professionals. CWD also suffers from antiquated procedures and work methods. All routine maintenance and most periodic

maintenance is carried out through force-account, using decades-old spending yardsticks and often primitive, short-lived, and inefficient maintenance techniques. Finally, consultation with road users and their participation in decisionmaking, maintenance, and monitoring is very limited.

The Condition of the Road Network

5.4 While Punjab's road network has grown rapidly, M&R spending has lagged so much that most roads are in fair-to-poor condition and deteriorating rapidly. A survey of a representative sample of 17,000 km of various categories of roads (excluding national highways and local government roads) found approximately 96% of them in fair-to-poor condition. This deterioration constitutes a huge impending liability, as real and concrete as other contingent fiscal liabilities like non-performing loans or civil service pensions.

5.5 According to CWD's estimates, as much as Rs 7.5-8 billion may need to be spent annually on M&R of the current road network just to maintain its present condition.¹ Since the province currently spends only about Rs 2 billion annually on road M&R, it is already incurring a substantial additional liability for every year that it defers the required maintenance. This road infrastructure "deficit" will continually increase as the cost of maintenance rises with the deterioration of unrepaired roads. It normally costs more than five times as much to restore a road from poor condition to good condition as it does to upgrade the same road from fair to good condition. Despite large M&R requirements, and the province's shift of priorities away from road network expansion and in favor of maintenance and improvement of existing roads, Punjab at present still spends about Rs 1-2 billion every year on creating new road assets. These new investments probably lose three to four times their expenditure in the value of roads whose required maintenance is deferred, adding to the future road infrastructure deficit.²

5.6 Persistent underspending on road maintenance is increasing the cost of transporting people and goods. The costs to transporters of operating on poor roads are nearly twice those of operating on good roads in Punjab (see Table 5.1). This means that Punjab's economy bears additional transport costs estimated at Rs 8-9 billion per year due to the condition of its road network. Another cost is human. According to 1997 data, 2,742 people were killed in road accidents in Punjab – more than seven people every day. Overall accident and injury statistics are much higher. Although available data are not sufficient to allow estimation of the resulting costs to Punjab's economy, death and accident rates highlight the significance of road safety problems in Punjab, which may be aggravated by underspending on road maintenance.

5.7 A major contributing factor to road deterioration is the failure to enforce limits on the weight that trucks are allowed to carry per axle. As a result, 88% of all trucks using Punjab's roads exceed the per axle load limit of eight metric tons; 43% exceed the new proposed federal load limit of 12 tons per axle. Calculations for local road conditions and local truck types show that a truck loaded at 12 tons per axle destroys roads five times as fast as a truck loaded at eight tons per axle, so a road with a ten-year design life will fail in two years under such burdens.

¹ Based on data provided by Road Management Unit and M/s Finnroad Finnra Oy for a representative sample of 17,000 km of the more than 37,000 km roads under CWD.

² The diversion of resources from M&R to new road construction increases the road infrastructure deficit for two reasons: (1) the additional deterioration of the road network due to diversion of these resources from M&R increases the future deficit for the existing road network, and (2) the new road assets created by the investment will require maintenance, raising future M&R requirements.

Table 5.1: CONDITION OF ROADS UNDER PUNJAB COMMUNICATIONS AND WORKS DEPARTMENT^{1/}

Road Class	Total, km	Good (IRI ^{2/} <5)	Fair (5<IRI<10)	Poor (IRI>10)
Access Road (t<1000vpd)	7751	407 5%	6581 85%	763 10%
VOC ^{3/} Rs/km		2,972	3,906	5,500
Secondary Road (1000vpd<t<10000vpd)	5267	140 3%	4263 81%	864 16%
VOC, Rs/km		20,703	26,897	39,009
Provincial Highway (t>10000vpd)	4256	122 3%	3836 90%	298 7%
VOC, Rs/km		25,762	34,736	51,157
Total Roads surveyed	17274	669 4%	14680 85%	1925 11%

^{1/} Data provided by Road Management Unit and M/s Finnroad Finnra Oy for a representative sample of 17,000 km of the more than 37,000 km roads under CWD.

^{2/} International Roughness Index in m/km.

^{3/} Vehicle operating cost in Rs/km. These costs have been worked out for average traffic in vehicles per day for each category of road in Punjab. Traffic mix data – i.e. percentage of trucks, buses, tractors, cars, etc. for each category of road – has been calculated from “Summary of Traffic Data for Punjab Highways,” published by the Planning and Design Directorate of former Punjab Highways Department.

Source: Amer Zafar Durrani, Vehicle Operating Cost Study for Pakistan (Draft, Work Bank August 1996).

Planning, Budgeting, and Cost Recovery Failures

5.8 The deteriorating state of Punjab's roads reflects a failure of planning and budgeting. New road building is driven not by proper, integrated, province-level planning and priorities but rather by improvisation and local politics. Many institutions invest in and maintain rural roads in Punjab, with the result that neither integrated development nor coordinated M&R take place, and no single agency is clearly accountable. Anecdotal evidence suggests that new schemes are undertaken on political directives or on the basis of instinctive choices based on experience. Not only is centralized management not providing relative rankings or prioritization of development schemes, but also no broad-based community participation/involvement goes into the planning and design of rural access/farm-to-market roads. Some so-called farm-to-market roads go where there are neither farms nor markets.

5.9 Poor planning and budgeting results in a road network that is overextended and includes many roads of doubtful economic value. Not only are the economic returns to road investments low, but limited funds available for M&R get further overstretched and used in part to maintain uneconomic roads that should not be there in the first place.

5.10 As a consequence of misplaced priorities and spreading funds too thin, CWD's portfolio of Rs 12.7 billion worth of road projects under construction represents more than six years of development funding at current levels, with another Rs 2.5 billion of works expected to be initiated in 1999/00. More than half of the current road investment portfolio, moreover, has progressed less than 10% in each of the last two years, meaning that essentially no substantial

work has taken place.³ Based on a very conservative analysis, this non-performance translates into a loss of Rs 2.7 billion to the economy in transport costs alone in 1999/00.⁴

5.11 The same improper management practices affect road maintenance planning and budgeting. Outdated yardsticks are used to prepare road maintenance budget estimates, and the releases go as block allocations without confirming actual needs. Since the province lacks comprehensive data on its road network, proper maintenance planning does not occur, and maintenance spending is mostly reactive. Much of it goes to the roads in the worst condition, an inefficient use of meager M&R resources. Although the province has been updating its road network data under a Nordic Development Fund program, institutional hurdles have held back efforts over the last five years, and data collection remains incomplete. The mechanism for collecting data on asset inventory, asset condition, and performance needs to be further improved and made more sustainable.

5.12 Turning to road sector finances and cost recovery, between 1990/91 and 1995/96 Punjab collected Rs 5,429 million in road-related revenues, of which Rs 561 million (10%) came from general revenue taxes (provincial receipts from vehicle registration and transfer fees) and Rs 4,868 million (90%) from motor vehicle taxes and various small fees and levies. In the same period, Punjab spent a total of Rs 13,780 million on the road sector, implying a sectoral expenditure – revenue gap of Rs 8,351 million (more than 60%). The situation is no different today. If maintenance spending is to be increased as it should be, the cost recovery ratio will need to be greatly enhanced.

5.13 CWD's annual road budget (Rs 5 billion on average) accounts for 6.5% of Punjab's total annual expenditure budget and approximately 15% of the province's annual development expenditures. Of this road budget, 63% consists of development expenditure, 24% is M&R, and 13% is spent on establishment charges (see Table 5.2). Generally, on a network in good condition (less than 15% each in poor and fair condition), a highway agency should be spending about 6-14% of its total budget on routine and periodic maintenance. However, CWD's network is not in good condition, which means that the maintenance backlog is large, and much more spending on M&R is needed than under normal conditions.

Institutional and Capacity Constraints

5.14 Punjab's road sector institutions suffer from overstaffing, inadequate capacity in qualitative terms, antiquated management procedures, and an inward-oriented corporate culture that ignores the customers – road users. There is also a problem of institutional fragmentation. Four major public sector agencies deal with Punjab's road sector: the Punjab Communications and Works Department (CWD), the National Highway Authority (NHA), the Punjab Local Government and Rural Development Department (LGRDD), and the Provincial Irrigation and Power Department. In addition, various urban autonomous bodies under either the LGRDD or the Public Health Engineering and Physical Planning and Housing Departments (PHED and

³ The average progress of works every year on these schemes should be around 50%.

⁴ Traffic on roads other than Farm-to-Market Roads varies between 5,000 to 15,000 vpd (vehicles per day) in Punjab. Taking the lower number and translating it into PCUs (passenger car units) assuming only 10% commercial traffic, we have a figure of 7,500 PCUs. Assuming that these works, which are mostly widening and improvement, would reduce vehicle operating costs by 0.5 Rs/km/PCU, the net saving lost due to these works not being operational in this year would be about Rs 2.7 billion.

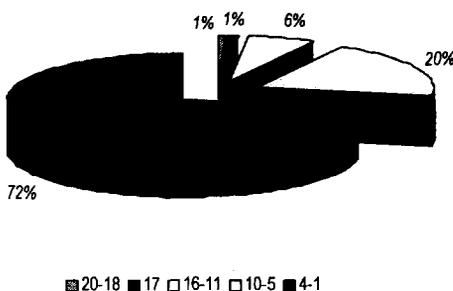
PPHD) are involved. However, CWD – with a total annual budget of approximately Rs 6 billion for roads and buildings, is responsible for more than 85% of the provincial road network. The following discussion focuses on CWD as the main responsible agency.

Table 5.2: COMMUNICATIONS AND WORKS DEPARTMENT – ROADS AND BRIDGES BUDGET
(Rs Million)

Category		1996/97	1997/98	1998/99	Average
Roads & Bridges	Alloc.	3,917	5,421	5,588	4,975
	Exp.	3,439	4,982	4,973	4,465
ADP	Alloc.	1,729	2,245	2,128	2,034
	Exp.	1,690	2,100	1,971	1,920
Establishment	Alloc.	571	662	763	665
	Exp.	564	624	599	596
M&R	Alloc.	1,160	1,193	1,294	1,216
	Exp.	728	937	1,000	888
ADB/OECF	Alloc.	457	1,321	1,403	1,060
	Exp.	457	1,321	1,403	1,060

5.15 CWD has 16,125 highway department employees – 40 per 100 km of roads – of which 8% are managing/supporting engineers – approximately one engineer per 150 km of road. By way of contrast, technical considerations and international experience suggest that 5-15 staff per 100 km of roads would be sufficient for a well-managed road agency that is appropriately out-sourcing work.⁵ CWD's overstaffing is just one aspect of its serious human resources problem. Both the quality and capacity of its personnel are weak, and the natural-attrition practices being followed by the provincial government to economize on staff have prevented CWD from recruiting the qualified and skilled professionals it needs to transform itself into a modern, commercially-oriented road department. At the same time, a large quantity of unskilled labor has been retained (see Figure 5.2), and antiquated departmental procedures and work methods have stifled innovation.

Figure 5.2: CWD: PERCENT OF ROAD EMPLOYEES IN THE VARIOUS CIVIL SERVICE GRADES



⁵ Heggie, Ian G. and Piers Vickers, "Commercial Management and Financing of Roads," World Bank Technical Paper No. 409, 1998.

5.16 A predictable consequence of CWD's organizational structure, management, and culture is a lack of project management skills, especially when contracting the private sector to do road works. Road projects face implementation delays, cost overruns, and claims. A vicious circle of sorts can be observed: CWD blames private contractors and service providers for delivering poor quality services; the contractors in turn blame CWD's management inefficiencies, outdated unit rates/prices, and corrupt practices; and CWD reacts by carrying out works through force-account (i.e. CWD's own management and labor gangs) or parastatal contractors, ending up with less efficient operations and less transparency.

5.17 All CWD routine maintenance and most periodic maintenance is carried out through force-account, using a decades old yardstick of Rs 20,300 km/year, which now should be closer to Rs 35,000 – 45,000 km/year. The maintenance procedures used by the Department's labor gangs and petty contractors are primitive, short-lived, and inefficient, damaging to the quality and quantity of routine maintenance delivered. CWD recently experimented with outsourcing some routine maintenance work to private sector contractors and found that the result was more costly – nearly Rs 36,000 km/year – a figure that led CWD to conclude that outsourcing in general would be more expensive. The actual reasons for the higher costs, however, were: (a) a measurably better quality of maintenance and (b) use of an outdated yardstick as a baseline.

5.18 CWD is not responsive to the concerns of road users. Even though half of CWD's road network consists of rural access/farm-to-market roads, no mechanism exists to involve users in M&R of these roads. Road users, who bear up to 85% of the total costs of road transport, are not consulted in design and planning, either. As a result users and rural households feel no sense of ownership and make no contribution toward M&R. Decentralization of rural roads to user groups would improve incentives to conduct necessary maintenance. Incorporation of users as part of the decisionmaking mechanism in the road sector would also strengthen the accountability of road departments and build ownership for increasing road user charges.

5.19 Pakistan's devolution initiative, under which responsibility for investing in and maintaining rural and farm-to-market roads will be given to the new district governments and road agencies will be consolidated into one at the district level, potentially can lead to improved quality of road services. This will require, however, that road users be brought into active participation, and that antiquated management practices be modernized and skills/capacity at the local level upgraded.

Recommendations for Road Sector Reforms

5.20 Resolving the problems discussed in this chapter, sharply reducing the road infrastructure deficit over time, and enhancing the value of Punjab's road system to users and to the economy will require major financial, institutional, and management reforms. A comprehensive road sector reform program would need to include the following main components:

- Rationalization of the road investment program (level of investment versus M&R, number of new project starts, reducing the throw-forward of the portfolio of ongoing works).
- Better planning and prioritization of road maintenance (including focus on the most economic roads with heaviest traffic).
- Development of an integrated multi-year road sector development and maintenance plan for Punjab, updated annually, with annual program budgeting.

- Institutional consolidation of road sector agencies at the provincial level and district level, with a single agency responsible for all road planning and regulation and for associated organizational streamlining and restructuring.
- Introduction of modern management processes (such as updated maintenance norms, sound financial management, contracting out maintenance works, etc.).
- Capacity building and skills upgrading in road management agencies, including through targeted training, better incentives and accountability (job audits and descriptions), and improved recruitment policies.
- Decentralization of management of rural and Farm-to-Market roads to local governments.
- Increasing participation by road users in planning, design, implementation, and M&R of rural access and farm-to-market roads.
- Higher cost recovery on the basis of better service to road users and their participation in decisionmaking.

5.21 Examples of specific measures that would improve road services in the short run include the following:

- Freeze new road works until the current portfolio is reduced to one year of carry-over works.
- Decide which works in the portfolio can be closed, and give top priority to closing them and settling related claims and liabilities.
- Maintain only roads that are functionally important and in reasonably good condition; develop a multi-year rolling maintenance program that identifies the core road network and its conditions.
- Budget separately for emergency works required to keep key roads open and serviceable, especially during monsoons and floods.
- Increase competitive out-sourcing of maintenance and rehabilitation works to the private sector. Consider the possibility of granting concessions for maintenance of roads carrying more than 15,000 vehicles per day as well as subsidized concessions on roads carrying 5-15,000 vehicles per day. Before implementing the above measures, assess the net burden on users and effects on transport costs and their externalities to other sectors.
- Downsize unskilled staff in grades 1-4 (mainly gang-laborers), through a combination of natural attrition, early retirement, and possibly a shift to contracting for small works. Some of the gang laborers perhaps could be organized into small maintenance contracting teams, with assured yearly work quantities phased out over time so that they start competing for work.
- Fund road maintenance through appropriate user charges such as fuel levies, toll taxes, axle-load charges, and transit fees, and rationalize existing road-related taxes to improve collection. The province is planning to establish a dedicated Road Maintenance Fund for this purpose. It would need to have considerable autonomy and a governing body including strong private sector representation.
- Conduct road safety audits and develop a plan for physical improvements coupled with information, education, and communications to improve road safety in the province.
- In coordination with other provinces and the federal government, develop and enforce axle load control measures. (Punjab is making a good start by setting up weigh stations along newly improved provincial highways.)
- Avoid new BOT, BOOT, and other such ventures until capital markets are better developed and the macroeconomic situation has improved.

6. FISCAL RESTRUCTURING

Overview

6.1 Fiscal restructuring is at the core of provincial reforms. Although Punjab is in a somewhat better position than the other provinces, as noted in Chapter 1 it suffers from deep-rooted structural fiscal problems:

- **Low revenue mobilization**, in large part related to the province's narrow, inelastic tax base but also reflecting failure to adequately exploit available broad-based revenue sources such as agricultural income tax, urban property tax, and user charges.
- **Reliance on federal transfers for some 80% of provincial fiscal resources**, which leaves Punjab vulnerable to the fluctuations and shortfalls in federal tax revenues that have been the normal pattern in recent years.
- **A rigid, skewed expenditure structure dominated by establishment costs, interest payments, and remaining provincial subsidies.**
- **Antiquated, ineffective planning and budgeting systems**, which have a short-term and input-focus, heavily emphasize incremental budgeting, hinder the translation of government policies into expenditure priorities, reduce the effectiveness of expenditures, and raise costs.
- **Weak financial management** including, among other problems, lack of budget clarity or transparency, delays and shortfalls in budget execution, inadequate fiscal monitoring, slow reconciliation of accounts, and narrowly-focused, non-performance-related auditing.

6.2 Sustained and multi-faceted efforts will be required to resolve these problems. The province has already made promising initial steps in several areas of fiscal restructuring, which need to be built upon, expanded, and consolidated into an overall fiscal restructuring program. The main elements include strengthening financial management, reforming planning and budgeting (within a medium-term framework), containing and managing contingent liabilities, and mobilizing more revenue. Issues related to fiscal decentralization are briefly considered at the end of the chapter.

Strengthening Financial Management

6.3 Better financial management – encompassing modern accounting and auditing, better fiscal reporting and information systems, effective financial controls, and more transparent budget presentation – is the cornerstone of Punjab's fiscal restructuring. Considerable progress is being made in improving financial management at the national level, and Punjab is participating in some of the reform initiatives. Notable examples include:

- The initial separation of auditing and accounting functions, with strengthened autonomy for the former, along with capacity building and technological upgradation.
- Announcement of a new accounting model and system of accounts.
- Establishment of federal and provincial Fiscal Monitoring Committees (FMCs).
- Timely reconciliation of accounts between line departments and account agencies.
- Regular public reporting of federal budgetary statistics.
- Establishment of ad-hoc Public Accounts Committees (PACs) to review audit reports in a timely manner and clear backlogs of nearly a decade in some cases.

6.4 Punjab needs to thoroughly implement this reform agenda. For example, reconciliation of accounts between line departments and accounts offices is still delayed and incomplete, which needs to be rectified. Summary provincial budgetary statistics should be regularly generated (at least on a quarterly basis) and reported to the public in a timely manner, as the federal government is already beginning to do. The provincial ad-hoc PAC, which has been established and has started work, needs to expeditiously review new audit reports and clear the backlog of old ones. Finally, local governments will be handling a large and growing volume of financial transactions and need to have their accounting system and auditing arrangements established on a sound foundation, fully consistent with practices at the federal and provincial level.¹ Over time, responsibility for the accounting function could be taken over by each level of government with respect to the accounts for its own activities.

6.5 **Budget presentation.** In addition to the new nationwide accounting system that has been announced, the clarity and relevance of Punjab's budget presentation can be enhanced. It is difficult for a non-specialist to disentangle the data and estimates presented in the various documents. Traditionally, the Punjab government has prepared five budget documents for the Provincial Assembly: (1) Annual Budget Statement (ABS); (2) Estimates of Charged Expenditure and Demands for Grants (Current Expenditures); (3) Estimates of Charged Expenditure and Demands for Grants (Development); (4) Annual Development Program (ADP); and (5) White Paper. Starting in 1999/00, the provincial government also prepared a sixth document, Performance Budgeting. In many ways well-prepared, these documents can be greatly improved in terms of presentation and clarity by making budget presentation consistent across documents; modernizing classifications (in line with the new charter of accounts); providing summaries of the object classification for the entire budget – development and recurrent; and making the budget presentation consistent with program budgets emphasizing performance.

6.6 To eliminate confusion between the ABS and the Current and Development Estimates/Demands, the three documents need to be made consistent in the coding and ordering of their presentation. At present, the budget documents contain no summary of the object (i.e. economic) classification for the recurrent budget, or for total expenditures. The ABS needs to include such a summary, and the economic classifications for both recurrent and development expenditures should be prepared. (Table 6.1 puts forward some illustrative proposals for changes in this regard.) Within the ABS, functional and key object classifications for major programs should be combined, consistent with the preparation of program budgets. This would make the budget more transparent in terms of program priorities. Finally, the budget presentation needs to be more comprehensive, including data on foreign financed development projects, finances of autonomous bodies, contingent liabilities, etc.

6.7 **Budget implementation.** Serious weaknesses in expenditure reporting and auditing make it difficult to assess the cost and effectiveness of many government programs. The Punjab government, for instance, does not issue actual expenditure data, although the Accountant General's Appropriation Accounts are issued by the Pakistan Audit Department after subjecting them to an audit test. There are often sizable shortfalls in actual expenditures as compared with the revised estimates issued near the end of the fiscal year. For example, in 1998/99, education,

¹ Local governments should have unified accounts for all of their resources and expenditures, in contrast to the present situation where they have different accounts for budgetary resources transferred to them by the province and resources they raise on their own.

health, irrigation, and roads and bridges spent 20-40% less than their final recurrent budget allocations, even though overall allocations were cut by only 11%.

Table 6.1: ILLUSTRATIVE CHANGES IN EXPENDITURE CLASSIFICATION

<i>Current Classification</i>		
	Annual Budget Statement	Estimates of Charged Expenditures
Functional Classification	8 Major Groups, some 50 plus minor groups	43 demands starting with Opium, and inconsistent with ABS
Economic and Object Classification	None	10 group object classification within each program.
Development Budget Project Information	None, but functional classification by 8 major groups.	In Estimates of Current Expenditure
Performance Indicators	None (separately in Performance Budget Book)	None (separately in Performance Budget Book)
<i>Proposed Classification</i>		
	Annual Budget Statement	Estimates of Charged Expenditures
Functional Classification	Adopt COFOG classification of 14 functions, with 60 programs	Adopt COFOG classification of functions same as in ABS.
Economic and Object Classification	Summarized, but more detailed object classification of entire budget	Provide more detailed object classification, with summaries for each sector. Some countries present more than 50 object classifications in each sector.
Combined Classification	For major programs identify key Object Budgets: e.g. under primary education identify wages and salaries, school supplies, school inspection budgets	Provide details of all object classifications under programs.
Development Budget Integration and Project Information	Mention key projects, the top 10 or so projects in each sector.	Mention Projects in detail.
Performance Indicators	Provide 2-3 performance indicators under each program (e.g. primary education).	None

6.8 The Accountant General's Office prepares Civil Accounts on the basis of accounts received directly from District Accounts Officers (DAOs). It sends this monthly accounting of spending under approved line item heads to the provincial line departments for their certification by the fifteenth of the following month. Unfortunately, in 1999/00 as many as one-third of these agencies did not reconcile their accounts with the monthly Civil Accounts. This compromises the quality of the accounts presented for auditing and then prepared as the Appropriation

Accounts of the Government of Punjab. There is no incentive to correct expenditure deviations because sanctions are not applied against departments that violate procedures. As a result, officials and the public cannot track actual expenditures very well.

6.9 Although better planning and budgeting – as well as higher and more stable revenues – will be necessary to address expenditure shortfalls over the longer term, there are procedural improvements which will also help in this regard. The province’s Fiscal Monitoring Committee needs to actively enforce reconciliation of accounts, and if necessary impose punitive sanctions against departments that fail to reconcile their accounts, which could take the form of suspending release of all or partial payments to the departments concerned until accounts are reconciled. Another option (not mutually exclusive) would be to designate a small group in the Finance Department to review the Civil Accounts each month, identify major over- and under-spending, and require line departments and agencies to explain and rectify these problems.

6.10 **Cash flow management.** There is considerable seasonality in the inflow of revenues for both the provincial and federal governments, with significantly lower receipts in the opening months of the fiscal year and of each quarter. On the other hand, at the provincial level most spending (i.e. wages and salaries, pensions, and interest payments) is regular and predictable and needs to be released on a monthly basis. Much of the non-salary component of recurrent expenditures has to be available relatively early in the fiscal year in order to be effectively utilized, for example for procurement of medicines or school supplies. In the case of the development program as well, smooth flow of funding is needed to ensure smooth project implementation. Given the seasonal mismatch between provincial expenditures and receipts, the province is allowed to take ways-and-means advances from the State Bank of Pakistan (SBP) to fund its activities on a short-term basis. Borrowing from SBP carries an interest rate of about 8% p.a., which is considerably higher on borrowed amounts exceeding the prescribed limit.

6.11 Punjab has generally maintained a relatively strong short-term financial position and hence has not had to rely much on borrowing from SBP. However, since 1997, as federal transfers fell substantially short of projections, Punjab (like the other provinces) faced a deterioration in its short-term financial position and imposed extra controls on expenditures. First, it imposed across-the-board cuts to make expenditures fit available resources. Second, it required a signed audit copy (authorization to spend from the Finance Secretary) before released funds could be utilized. And third, it banned certain types of expenditures (e.g. purchase of vehicles, furniture, air conditioners, etc). Although they have been effective in cutting expenditures, these tools of crisis management may have exerted a negative impact on non-salary recurrent spending and on the efficiency of expenditures. They may also explain why development expenditure has had a lower execution rate (ratio of audited to budgeted spending) than recurrent spending. In sum, these ad hoc controls are not appropriate tools for regular short-term budget management.

Reforming Planning and Budgeting

6.12 **Key problems and issues.** Planning and budgeting in Punjab, as in other provinces, need to be modernized. Existing budgeting procedures and structural rigidities in expenditure composition have turned budget preparation largely into an administrative routine, detached from policy objectives. Around 90% of total spending in the recurrent budget (75% of total expenditure) is classified as permanent expenditures and is not subject to close scrutiny during

budget formulation. Budget preparation circulars issued by the Department of Finance are exclusively requests to provide proposals for estimates according to the formats of the form.

6.13 Cabinet involvement in formulating strategic directions for the budget has been limited in the past, although there have been substantial improvements in this regard in the last year and a half. The Finance Department negotiates expenditure allocations for the SNE (Schedule of New Expenditures) – around 10% of total recurrent expenditures – with line departments before making expenditure allocation recommendations in the draft budget. However, more extensive Cabinet consideration of policy goals, priorities, and options or trade-offs early in the budget process would be beneficial.

6.14 A host of procedural and systemic defects prevent the Annual Development Program (ADP) from effectively meeting development priorities. The ADP contains such a large number of projects, each receiving a relatively small allocation, that delays in completing projects are inevitable and erode the efficiency of expenditures. The large “throw-forward” thus generated also makes development programming much more difficult. Budgeting of the ADP tends to be incremental, and there is no meaningful linkage between project-level decisions and sector strategies/programs or availability of funding. Moreover, selection and prioritization of development projects has been ad-hoc and sometimes distorted by political interventions, even in the case of smaller projects. Finally, development budgeting and execution are over-centralized, with provincial authorities directly in charge of many tiny minute projects. Issues related to planning and budgeting of the ADP are elaborated in more detail in Box 6.1.

Box 6.1: PROBLEMATIC ASPECTS OF DEVELOPMENT BUDGETING

Although broad national and sectoral priorities are supposed to guide preparation of the development budget, identification of priority projects is meant to originate with the respective line departments. The development budget is also intended to be linked to resource availability. In practice, however, the process fails to deliver good development spending outcomes or public expenditure management. This is due to flaws in design, built-in incentives, and extraneous factors (including political factors).

BOP Financing Needs Versus Development Priorities. Foreign exchange funds for ADP projects are routed through and retained by the federal government, which transfers the rupee equivalent to the provinces. Given the need for foreign exchange to finance balance-of-payments (BOP) deficits, the federal government may suggest that provincial authorities put forward development projects that are most likely to receive donor support. Federal guidelines for foreign-funded projects, moreover, insist on their being adequately funded, as do the guidelines issued by provincial planning and development departments to the various line departments.

Incremental Budgeting. As in the case of the recurrent budget, the guidelines for preparing the development budget are essentially incremental. A Planning and Development Division instruction for 1999/00 states: “The exact size of the Program cannot be indicated at this stage. However, the overall size of your budgeted development program should not be more than 10% above the allocations for the current year.” The evidence indicates that there is little effort to promote re-prioritization between sectors, whether this is required or not.

Disconnect Between Recurrent and Development Budgets. When a development project is initially considered, the relevant department is required to complete a PCI form which includes an estimate of the project’s future recurrent costs. There is no assurance, however, that this information is actually used when it is decided whether to embark upon the project. Moreover, the development budget as a whole, put together in isolation from considerations of resource availability for downstream O&M, does not have any substantive relationship or procedural connection with the recurrent budget.

Continued on next page

Box 6.1 continues

With programming for the development and recurrent budgets being undertaken by separate entities and almost independently of each other, sector departments are in a position to increase their access to scarce budgetary resources by initiating new development projects rather than completing ongoing ones. As a result, a large portfolio of ongoing projects that will call on the resources of the recurrent budget comes into being, without consideration of availability of resources. This missed connection is aggravated by the fact that revenue forecasting looks no farther ahead than one year. In addition, the artificial distinction between the recurrent budget and the development budget means that different criteria apply to funding decisions for activities under each, with high risk of mismatches.

By-Passing Procedures. Regular budgeting procedures frequently are bypassed. For example, some projects in Punjab's ADP budget are listed as "unapproved." The number of unapproved projects has been relatively small (79 out of 4,036 in the restructured 1999/00 ADP). Nevertheless, inclusion of unapproved schemes in the ADP represents a direct contravention of established procedures, and the provincial government rightly intends to eliminate this practice over time.

Political Intervention. The political leadership and individual politicians appropriately would mainly be involved in establishing the policy agenda. They need to act within, rather than circumventing, procedures for approval, financing, and monitoring of projects. In Punjab and other provinces, however, politicians and political considerations have been affecting a large portion of the ADP, spurring governments to initiate large numbers of new schemes and projects. Not only do many resulting ADP schemes bear little or no relation to sectoral priorities, but they also lack ownership in the executing agency/department.

The practice of earmarking part of ADP funds for projects identified by provincial elected representatives circumvented established ADP procedures, distorted sectoral priorities, led to inappropriate use of development funds, and – by giving the wrong signals to the beneficiaries – undermined efforts at cost recovery. Fortunately, programs involving local projects identified by provincial politicians have been terminated. It is essential, however, to prevent re-introduction of such programs in a different guise.

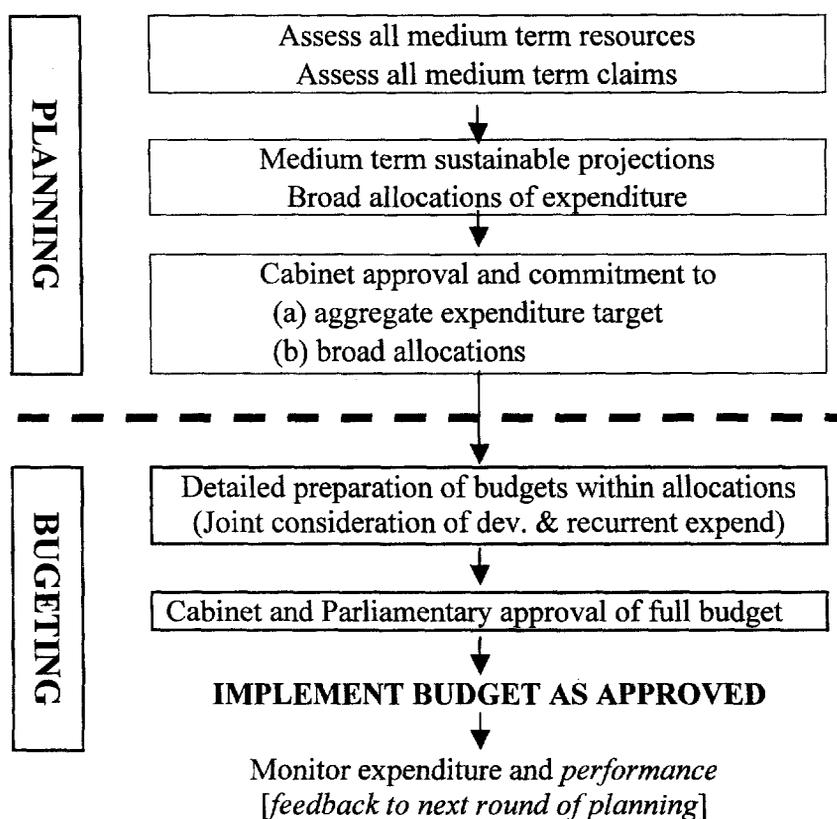
Transparency. The transparency of the development program – clouded by the inclusion of a number of block allocations – has been further compromised by the way it is presented in the ADP document, which focuses only on the locally financed portion of the development program. While the foreign project assistance (FPA) for each donor-assisted project (along with the name of the donor) is supposed to be listed in the ADP document, this instruction sometimes is ignored. Moreover, even when FPA is listed for individual projects, it is not added up to present a complete sectoral or aggregate provincial development program.

Overcrowding. Due mostly to these factors, and also because the ADP is initially prepared without consideration or knowledge of available resources to fund the development program, the ADP becomes "overcrowded" with a huge number of development projects. Available funds are thinly spread over so many projects that a number of them are allocated barely enough to pay wages and other associated expenditures of project staff. As a result, project completions are delayed, and economic and social returns shrink. For example, the original 1999/00 ADP contained about 4,500 schemes, costing over Rs 165 billion in all, with a total "throw-forward" of about Rs 59 billion (Rs 36 billion in local and Rs 23 billion in foreign funds). Restructuring during the year reduced the throw-forward of local funds by Rs 6 billion by deleting 400 locally financed schemes from the ADP. Still, the throw-forward has remained high, and the provincial government intends to reduce the domestic throw-forward to Rs 15 billion by the end of 2001/02.

6.15 **Performance-oriented program budgeting and the MTBF.** Meaningful performance budgeting within a strategic medium-term framework for public expenditure planning and management is required, especially to provide links between policies, performance, and the budget. A Medium-Term Budget Framework (MTBF) would be based on and would facilitate programmatic budgeting and prioritization over a multi-year period. The MTBF would also help achieve a better balance between capital and current spending, between wage and non-wage O&M, and between funding of new project starts and completion of ongoing projects. A medium-term time horizon provides much greater scope for adjusting expenditures that are rigid in the short run – such as the wage bill – and for changing sectoral and investment priorities. The MTBF can be introduced quickly at least in rudimentary form and can then be improved and refined over time. Figure 6.1 illustrates the concept of the MTBF as a process. Critical ingredients of this process include:

- Assessment of medium-term (at least three years) revenue prospects and expenditure claims, and setting aggregate expenditure targets and broad allocations across sectors and major programs, before detailed budgeting. This requires realistic projections of resources by both the provincial and federal governments.
- Performance-based program budgeting, based on sectoral objectives and strategies.
- A disciplined schedule which explicitly programs sufficient time for medium-term planning, to be followed by detailed annual budgeting.
- Political involvement and commitment, especially in the early stages, which could take the form of Cabinet endorsement of the medium-term framework.
- Comprehensive coverage of all provincial public sector institutions and activities, of both development and recurrent budgetary expenditures, of budgetary and non-budgetary public spending, and of all claims on the public sector.
- A clear delineation of core government functions and shedding of others over time.
- Annual roll-over of the MTBF to maintain a constant medium-term time horizon.

Figure 6.1: MEDIUM-TERM BUDGET FRAMEWORK



6.16 The MTBF needs to be supported by greater clarity and transparency of budget documents (for decisionmakers and the public); integrated budgeting of recurrent and development expenditures; changes in budgetary classification and procedures; and use of a limited number of performance indicators to evaluate progress. Greater buoyancy and stability of federal transfers (based on improved federal revenue collection) would facilitate medium-term programming by the provinces. The MTBF also requires capacity building both in the Finance

Department and in sectoral agencies – for fiscal analysis and projections, sector strategy formulation, program and performance budgeting, etc. Large discrepancies between budget targets and actual spending, which have been the norm, need to be minimized. Budget implementation also needs to be greatly improved. Processes for release and spending of budget allocations need to be streamlined, subject to effective monitoring and auditing.

6.17 As part of the effort to develop sector- and program-based budgeting under the MTBF, the following reforms in the development budgeting process would be desirable:

- Better integrate the project preparation process with sectoral and program planning.
- Link ADP programming closely to the resource envelope and sector and program objectives.
- Undertake a thorough “spring cleaning” of the ADP by deleting problem projects, those which have become inconsistent with government priorities, and those which cannot be adequately funded for near-term completion.
- Combine small schemes into programs, which will help to sharply reduce the number of line items in the ADP.
- On the basis of the above two measures, restructure the ADP to contain no more than a few hundred significant projects and programs.
- Reform ADP procedures to avoid future overloading. Change incentives to prevent a large number of new projects from entering the ADP every year.
- Improve the transparency of the development program by explicitly including foreign financing (foreign project assistance – FPA), as the Federal and Balochistan governments already do, and by including all non-budgetary public sector investments (e.g. self-financed investments of provincial autonomous bodies) as a separate section in the ADP document.

6.18 **Improving incentives and management for foreign-financed projects.** The share of foreign financing in Punjab’s development program rose during the latter half of the 1990s – from 21% in 1994/95 to a third in 1999/00. Donor-supported projects typically involve a number of important actors – one or more levels of government, line departments, political actors, and donor agencies, each facing different incentives. Some of the key incentives that appear to have a significant influence over donor-supported projects include the following:

- Augmenting development resources for the sector concerned and making claims on counterpart funding (provincial line departments).
- Mobilizing BOP financing (federal government, donor agencies).
- Demand for large, visible projects with substantial project-related employment creation and contracts, equipment imports (politicians, provincial line departments).
- Strong technical project design (donor agencies, provincial line departments).
- Generous funding and staffing of project management units, in the interest of timely project implementation (donor agencies, provincial line departments).

6.19 These incentives have several implications. First, at the initiation and approval stages, gaining access to BOP financing and securing project-related employment opportunities may have tended to override concerns about the province’s medium-term fiscal position. This has led to funding shortfalls and delays for ongoing projects, as well as inability to cover the recurrent costs associated with completed projects. Second, there have been tendencies to go for large projects. Whereas the bulk of the domestically-funded projects in Punjab’s ADP are small and facility-specific, on the other hand some donor-supported projects may have been too large in relation to sectoral objectives and the province’s fiscal and administrative capacity. Third, segregated, well-funded project management arrangements may facilitate project implementation

narrowly construed but may also inadvertently generate disincentives in the rest of the service delivery network and management apparatus. There may even be demand for new donor-financed projects to keep project-related staff employed and provide continuing access to project-related resources.

6.20 In sum, the economic and social returns of foreign-financed projects may be adversely affected by the playing out of incentives among the different actors involved. There may also be significant negative effects on incentives and outcomes more broadly in the sectors concerned, as well as for the development program as a whole and the province's fiscal position. Some options for better aligning incentives related to foreign-financed projects with provincial development needs are outlined below:

- Rely more on policy-based lending and program support to help meet BOP financing needs. Traditional investment projects are not very well-suited for this purpose, since they are slow-disbursing and often have a high import content.
- Place investment projects under the umbrella of a province-wide reform program and sector policy package, with full ownership by the provincial government and within a consistent fiscal resource envelope (relating both to counterpart funding and to downstream recurrent expenditure requirements).
- Minimize reliance on project-specific (often temporary) implementation institutions with segregated staffing and privileged access to resources. Instead, focus on institutional strengthening and capacity building for the sector/program as a whole.
- Encourage regular interactions between visiting donor project missions and provincial core agencies, particularly at early stages in the project cycle.
- Ensure meaningful participation by the provincial core agencies (Finance Department in particular) in the decisionmaking to initiate and approve all donor-supported projects.
- Allocate counterpart funding for donor-supported projects on the basis of their priority in the overall provincial development program.

Containing and Managing Punjab's Contingent Liabilities

6.21 Punjab's public sector finances are in worse shape than is indicated by the budgetary statistics, primarily on account of civil service pension liabilities and the liabilities of provincial autonomous bodies. Moreover, there are serious downside risks for the future if these contingent liabilities are not effectively contained and well managed.

6.22 **Civil service pensions** are a time bomb that will explode in the next decade or so if nothing is done. Having jumped from Rs 1.7 billion in 1990/91 to Rs 7.8 billion in 1999/00, pension payments in the provincial budget will continue to increase very rapidly in the absence of remedial action. This would put enormous strain on the province's budget and take away much needed fiscal space. The first step toward bringing Punjab's civil service pension costs under control is obtaining and analyzing accurate information. A carefully-conducted Census of all public sector pensioners will be necessary to get accurate information on their numbers and pension payments and weed out "ghost pensioners" (i.e. pensioners who do not exist or who have died and are no longer eligible for pensions for themselves or their families). Second, based on complete data on the age distribution of existing civil servants, Punjab's future civil service pension costs can be projected on an actuarial basis.

6.23 The federal government is considering measures to rationalize civil service pensions and contain their costs, based on the work of a Pay and Pensions Committee that included representatives of the provinces. Together with demographic trends in the civil service, undiscounted commutation of half of each civil servant's pension entitlement upon retirement has been a major factor contributing to exploding pension costs. Thus rationalization of pension commutation provisions – i.e. their elimination for new employees and suitable modifications for existing employees so that the future pension burden can be alleviated – will need to be a central element of a pension reform package. Introducing a contributory element in civil service pension financing would also help contain the fiscal costs. Pension issues are further discussed in Chapter 7 in the context of civil service compensation reform.

6.24 **Autonomous bodies.** The other main source of contingent fiscal liabilities is the 119 operational autonomous bodies under the provincial government, engaged in a wide range of social services, commercial, promotional, and other activities. Established for the most part by special Acts of the provincial government, the autonomous bodies include about 20 colleges and universities, 18 development authorities, 14 hospitals and medical institutions, 22 schools, nine secondary boards, and 13 corporations or boards engaged in commercial activities or business promotion. Even the commercially-oriented entities do not earn any significant financial returns for the provincial exchequer. On the contrary, in 1999/00 Punjab's budget allocated Rs 7 billion for the autonomous bodies – Rs 3.8 billion in grants-in-aid in the recurrent budget and Rs 3.2 billion in the development budget (about 17% of the total budgeted ADP). But this is only the tip of the iceberg. The provincial government's outstanding loans to the autonomous bodies, nearly all of them non-performing, total more than Rs 35 billion, and an additional Rs 6 billion of bank loans to autonomous bodies, also non-performing, have been guaranteed by the provincial government.² Finally, the more than 100,000 employees of the autonomous bodies represent an unfunded pension liability of something like Rs 500 million per year and a much larger potential liability for separation payments if they are closed down or sold.

6.25 The provincial government has made progress in privatizing some commercially oriented autonomous bodies, closing others, reducing their fiscal burden, and using asset sales to retire provincial debt.³ In 1997 the Punjab Privatization Board (PPB) was established to lead this process. PPB has succeeded in auctioning off more than 800 properties, with net proceeds of about Rs 2.6 billion. The vast majority of these have been real estate properties such as state land, rest houses, and resorts. Three sugar mills also have been sold to the private sector for a sum of Rs 2.1 billion. After the present government came into power in October 1999, PPB's operations slowed down, for various reasons including the withdrawal of immunity for prospective buyers with respect to the source of their funds. PPB has more than 1,300 properties listed for auction, with an estimated value of about Rs 5 billion.

6.26 Restructuring of Punjab's autonomous bodies is an important component of overall provincial fiscal restructuring. This would help create fiscal space, get the government out of commercial and other non-core activities it should not be engaged in, and most important,

²Out of the Rs 6 billion of provincial government-guaranteed bank loans, more than two-thirds consists of loans to the defunct Punjab Road Transport Corporation (PRTC) – Rs 1.8 billion – and to the Punjab Cooperative Bank – Rs 2.4 billion. PRTC also owed Rs 11 billion to the provincial government, comprising nearly one-third of the total borrowing of all autonomous bodies from the provincial government.

³For example, the following entities, among others, have been disbanded: Punjab Industrial Development Board, Punjab Agricultural Development and Supplies Corporation, Punjab Road Transport Corporation, Murree Kahuta Development Authority, Bahawalpur Development Authority, and Dera Ghazi Khan Development Authority.

contain the large contingent liabilities associated with the autonomous bodies. A possible approach is sketched out below. The provincial government first needs to clearly define the kinds of “public goods” it wants the autonomous bodies to supply and in that context conduct a review of the rationale for all autonomous bodies and their appropriate roles and activities. Such a review should be carried out with independent professional advice.

6.27 The autonomous bodies could then be classified in five categories set forth below. Several considerations need to be taken into account – whether the autonomous body concerned is delivering core public services that are in demand, what option generates the maximum fiscal savings, what are the costs of adjustment, and how can the provincial government’s social objectives be addressed. Table 6.2 suggests an initial classification of some of the autonomous bodies on an indicative basis.

- **Privatization:** The entities in this category include those producing private goods/services, where there is no good reason for government ownership.
- **Retention with greater autonomy:** Autonomous bodies with a clear social function, or where the private sector lacks the capacity to fill the gap, can retain their status. However, greater autonomy and financial independence can be pursued over the medium-term if appropriate for the sector and institution concerned.
- **Merging and restructuring:** When there is duplication or complementarity in the operations of several autonomous bodies, they need to be merged and restructured for synergy and cost savings. This option should also be considered in cases of overlap or duplication between federal and provincial entities.
- **Transfer to local government:** Municipal agencies (development authorities and WASAs) would be transferred to the new district governments.
- **Closure:** Institutions that have no social role, fill no demand for services, and have no potential for profitability even in the private sector need to be closed.

Table 6.2: ILLUSTRATIVE OPTIONS FOR RESTRUCTURING AUTONOMOUS BODIES	
Category of Action	Sample of Institutions
i. Privatize	Bank of Punjab Punjab Mineral Development Corporation Tourism Development Corporation of Punjab Punjab Dairy Corporation Punjab Seed Corporation
ii. Retain with greater autonomy	Hospitals Medical Colleges Colleges and Universities
iii. Merger and restructuring	Secondary Boards Punjab Special Education Services Board Sunrise Institute for the Blind Government Institute for the Blind
iv. Transfer to local governments	Development Authorities WASAs
v. Close	Punjab Agricultural Development Board Punjab Small Industries Corporation Punjab Sports Board Punjab Local Government Board

Revenue Mobilization

6.28 Although Punjab currently depends on federal transfers for about four-fifths of its budgetary resources, greater revenue mobilization from provincial and local taxes and user charges would expand the province's fiscal space at the margin and, over time, would enhance fiscal autonomy. The province has already sharply reduced its numerous, mostly low-yielding taxes and has strengthened the urban property tax and agricultural income tax. Nevertheless, much more can and should be done to give Punjab a broader, more buoyant revenue base.

- **The Agricultural Income Tax (AIT)**, whose receipts have been in the range of Rs 600-1,000 million annually (far below the potential yield), can be sharply increased to at least Rs 4 billion per year over a period of several years. The potential of Punjab's AIT and various options for increasing its revenue yield are discussed in Box 6.2.
- **Urban Property Tax** accrues to local governments, so raising its yield will provide fiscal space for devolution. Receipts could be doubled from Rs 1.9 billion annually at present to at least Rs 4 billion by redefining the mode of calculation, improving the database, and decentralizing collection as has been piloted in two urban areas of Punjab. Issues related to the urban property tax are covered in Box 6.3.
- **General Sales Tax (GST) on services.** This is one of the most buoyant revenue sources Constitutionally assigned to the provinces. Although GST on services is collected by the federal government, provincial receipts can be increased by expanding the list of services covered by GST.
- **Motor Vehicle Tax** receipts increased somewhat in 2000/01. This tax could be shared with local governments, and the revenue yield further increased in consultation with the other provinces.
- **User charges** have considerable scope for enhancement, particularly for economic infrastructure and urban services, as well as to a lesser extent at the tertiary level for social services. For example, a Road Maintenance Fund could be established, with considerable autonomy and a governing body including strong private sector representation, into which road user charges would flow and then would be allocated for road maintenance and repairs.

6.29 Restructuring of the tax administration will be essential for rapid and sustainable growth of provincial revenues. At present the provincial Board of Revenue and Excise and Taxation Department both collect different taxes. All provincial tax collection functions would best be consolidated in a single agency. This consolidation needs to be accompanied by administrative restructuring, skills upgrading, rationalization of staffing, better incentives, effective accountability mechanisms, and modernization of business processes.

Fiscal Decentralization

6.30 Fiscal decentralization – encompassing both decentralization from federal to provincial level and from provincial to local level – forms an integral part of provincial fiscal restructuring and devolution. It is also very important more broadly for improved service delivery.

Box 6.2: THE POTENTIAL OF THE AGRICULTURAL INCOME TAX (AIT)

Punjab has made some progress in recent years in instituting meaningful agricultural income taxation. The base of Punjab's AIT is "net area sown." Landowners with less than 12.5 acres are exempt from tax. If the net area sown exceeds 12.5 acres, the entire acreage is subject to tax at the applicable rate. The rate is Rs 100 per acre for irrigated land if the area sown is less than 25 acres, Rs 300 per acre if it is between 25 and 50 acres, and Rs 350 per acre if it exceeds 50 acres. For unirrigated land the tax rates are half those for irrigated areas. In its 2000/01 budget, Punjab introduced an income-based tax for large farmers (over 50 acres), with tax rates of 5-15%, and also reduced the exemption limit for irrigated land from 12.5 acres to five acres. These were very positive steps, but the reduction in the exemption limit was subsequently reversed. Subdividing holdings on paper to fall below the exemption limit appears to be a very common practice, which sharply reduces the revenue yield from the land-based portion of the AIT. The majority of agricultural land probably escapes agricultural income taxation for this reason.

Recently the federal government has proposed a nationwide uniform system of agricultural income taxation, very much along the lines of the Punjab model. For the land-based portion, the exemption limit is to remain at 12.5 acres for irrigated land and 25 acres for unirrigated land, and rates of land-based taxation also remain the same. The income-based portion of AIT will apply to persons with landholdings of at least 50 acres, and moreover there is an exemption limit of Rs 80,000 annual income (double the previous exemption limit for non-agricultural personal income tax). Income tax rates remain low: 5% on income up to Rs 100,000, 7.5% on the portion between Rs 100,000 and Rs 200,000, 10% on the portion between Rs 200,000 and Rs 300,000, and 15% on all income above Rs 300,000. Given the high exemption limit in terms of landholdings and the widespread practice of subdivision to avoid the land-based tax, the income-based portion of AIT probably will apply to relatively few landholders and will have a small revenue yield. Moreover, the capacity of the provincial taxation departments to implement effectively and monitor the income-based part of AIT is in question.

Building on the progress described above, there is great scope for enhancing the yield of Punjab's AIT. Actual collections from the AIT were Rs 562 million in 1997/98, and Rs 1 billion in 1998/99, but only Rs 628 million in 1999/00 and 685 million in 2001/01. Hence the introduction of the AIT has not meant a breakthrough yet in imposing higher direct taxes on the farm sector. If anything, the burden of tax seems to have declined from that under the old land revenue and Ushr system in the early 1980s, although it is greater than the level immediately prior to the introduction of the AIT in 1996.

Moreover, the burden of direct tax borne by the agriculture sector appears minuscule as compared with the burden of the non-agriculture sector. The share of direct tax on agriculture as a percentage of value added in agriculture is about 0.15% in Pakistan as a whole and 0.22% in Punjab, whereas it is 6% for the non-agriculture sector. If farmers in Punjab were to have the same burden of direct tax as their counterparts outside the agricultural sector, collections from AIT would have been something like Rs 25 billion in 1998/99.

Potential AIT receipts also can be estimated based on farm incomes, using cost of production calculations by the Agricultural Price Commission for each of the four major crops and using farm-size distribution figures from the 1990 Agriculture Census. On this basis, the potential revenue from a full-fledged income tax on agriculture is estimated at about Rs 10 billion. If more crops were included, this figure would rise.

A smaller estimate of total AIT revenue which nevertheless represents a healthy increase – Rs 3 billion – would result from changing the tax base from "net area sown" to "cropped area." This would double the tax yield from land where two crops are grown per year and also improve equity. If the exemption limit is lowered from the current 12.5 acres to five acres, the tax yield from these combined measures would increase to Rs 4 billion.

All of these calculations indicate that there is very substantial untapped revenue potential from agricultural income taxation. Punjab's AIT needs to be made into a larger and buoyant source of revenue. Implementing a regular income tax on agriculture will take time because the collection capacity and information base need to be developed. In the short run, it would make sense to start collecting income tax from the largest and corporatized farmers and to increase AIT revenue sharply by reducing the exemption limit for the land-based portion of the AIT, perhaps back to the five acres that Punjab instituted in 2000 but then withdrew. NWFP, with a zero exemption limit but a very low tax rate, provides another example which may make sense in terms of administrative convenience and curbing the tendency to avoid tax by subdividing holdings.

Any system that uses cropped area as the base suffers from the discretion available to the *patwari* (lowest level land revenue official, stationed in a rural locality), whose assessment and records form the basis of tax valuation. Without a system of checks and balances, there is ample scope for corruption. A move toward a modern taxation system for agriculture should also be accompanied by upgrading the revenue record system in agriculture and reforming of the antiquated institution of the *patwari*.

6.31 **Federal-provincial fiscal relations** have been discussed in detail in Chapter 2 of the report: Pakistan: Reforming Provincial Finances in the Context of Devolution: An Eight Point Agenda. Some of the key themes that emerge from that report's analysis, which also relate to the role of the federal government (see Chapter 1), are summarized below. These issues would be explored in depth and addressed by the National Finance Commission (NFC) as it develops the next NFC Award for revenue sharing between the federal government and the provinces.

Box 6.3: REVAMPING THE URBAN PROPERTY TAX

The present yield of the Urban Immovable Property Tax (UIPT) in Punjab is just under Rs 2 billion annually, and the bulk of receipts are transferred to municipal authorities. Punjab has made considerable progress in restructuring the UIPT for higher revenue yield and much less discretion in assessment and collection. Moreover, responsibility for levy and collection of the UIPT was successfully devolved to local government on a pilot basis in two zones of Lahore. The provincial government estimated that these measures easily could double the revenue yield of the UIPT to at least Rs 4 billion within three years.

Previously, UIPT had been calculated on the basis of Annual Rental Value (ARV), assessed with considerable discretion by the personnel of the provincial Excise and Taxation Department. Moreover, there were serious weaknesses in the structure of the UIPT, including lack of buoyancy due to failure to update values, inequities in the treatment of owner-occupied and rented property and new versus long-established properties, and other significant problems. (Problems and issues associated with the urban property tax in the past are discussed in Annex G of the report Pakistan: Reforming Provincial Finances in the Context of Devolution: An Eight Point Agenda.)

During 1999/00 Punjab introduced a new valuation method for UIPT, whose ultimate basis is the value of land and construction costs of the property concerned. The "capital value" derived in this manner was then converted into an annual rental value – at the rate of 1% – and UIPT was then assessed at the rate of 20% of the rental value, i.e. 0.2% of the calculated capital value. However, the tax was assessed at 25% if the calculated rental value exceeded Rs 20,000. This new mode of calculation of the UIPT was initially applied in 40 of the 118 rating areas of Punjab, with a plan to expand it in a phased manner to all rating areas by June 2001.

Unfortunately, the new mode of UIPT calculation was contested in court, and in April 2001 the Lahore High Court ruled that it was illegal because (1) it was effectively a capital value-based tax – and taxation of capital values is a federal subject, and (2) it was discriminatory as it was applied only in some of the rating areas and not in others. This ruling was upheld by Pakistan's Supreme Court in June 2001, so the reformed mode of calculation for UIPT stands abolished. As a result, the provincial government is required to go back to the old ARV-based mode of calculation, with the associated discretionary powers of tax officials in assessing ARV of individual properties. Punjab is now working on a new model which would be acceptable Constitutionally, would reduce the discretionary powers of tax collectors, and can be put in place during 2001/02. This effort is critical because there is undoubtedly great revenue potential in urban property taxation – going well beyond the Rs 4 billion estimated by the provincial government – and this will be by far the most important revenue source for urban local governments.

6.32 Pakistan is characterized by large vertical fiscal imbalances, since the provinces have been assigned major expenditure responsibilities whereas most buoyant and high-yielding tax revenue sources are exclusively collected by the federal government. The provincial (and local) governments have been left with residual taxes, for the most part characterized by narrow bases and low buoyancy. This, coupled with poor utilization of provincial and local taxes and user charges, has contributed to the widening gap between provincial expenditures and revenue collection. The provincial governments collect only about 6% of total national revenue but are responsible for 25% of expenditure. This vertical imbalance is far greater than in other federal countries like Canada, Brazil, India, or the USA. With federal revenue transfers accounting for 80% of total resources in the case of Punjab (and even higher proportions in the two smaller provinces of NWFP and Balochistan), the provinces' fiscal position has become highly vulnerable to changes in federal tax policy and fluctuations in federal revenue mobilization. Moreover, the large disconnect between revenue mobilization and expenditure responsibilities

impairs the accountability of provincial governments to the taxpayers and also weakens the incentives for the provinces to mobilize more revenues.

6.33 Reducing vertical fiscal imbalances thus would be desirable for a variety of reasons. On the other hand, Pakistan has made considerable progress in improving collection and broadening the base of the General Sales Tax (GST), which is centrally administered, and is embarked on programs to strengthen income taxation and thoroughly revamp tax administration. Clearly, it would not be desirable at present to compromise this progress by handing over collection responsibility for major federal taxes to the provinces with their very limited capacity in tax administration. Keeping in mind these trade-offs, some options for expanding the provincial revenue base and reducing vertical fiscal imbalances would include the following:

- Consider allowing the provinces to share selected federal taxes (such as personal income tax and possibly GST) through levying “add-ons” on the federal taxes, with federal collection but provincial responsibility for use of the resources generated and, at least over time, for setting supplementary rates. This would require adjustments in federal tax rates to avoid over-utilization of tax bases and provide space for the provincial add-ons, and the general revenue sharing rate from the federal divisible pool would need to be appropriately adjusted.
- The federal government can vacate tax bases which under the Constitution are assigned to the provinces, for example capital value taxes on provincial bases.
- Revenue from energy resource taxes (which Constitutionally belong to the provinces) could be shared on the basis of the divisible-pool formula, or these taxes could be devolved to provincial governments, as opposed to the present practice of the federal government collecting these taxes and then transferring the receipts to the provinces.
- Specific-purpose excise duties (e.g. on cigarettes and tobacco) could be assigned to the provinces, or the provinces could share these bases with the federal government.
- Horizontal imbalances which may be generated as a result of revenue devolution would need to be corrected by means of well-designed fiscal equalization grants from the federal government to the economically weaker provinces.
- Finally, a clear delineation of the core roles and activities of the federal and provincial governments, transfer of non-core activities to the private sector and restructuring to eliminate unwarranted duplication would be a prerequisite for redesigning the federal-provincial fiscal structure and revenue-sharing arrangements.

6.34 **Provincial-local fiscal decentralization.** As was noted in Chapter 1, fiscal aspects of devolution will be critical for its success. Even with strong resource mobilization by local governments, the bulk of their resources will have to come from the provinces. Provincial-local fiscal transfer mechanisms therefore need to be well-designed, and there is also a need for sound transitional arrangements.

6.35 Revenue sharing arrangements between provincial and district governments are to be calibrated by Provincial Finance Committees established in each province. Ultimately, all transferable provincial resources (including both federal transfers to the province and the province’s own revenues) will be placed in a provincial “divisible pool”, which will be distributed among the districts according to a specified formula. A possible formula, which has been put forward by the National Reconstruction Bureau, includes the following elements:

- District population (possible weight 50%).
- Tax potential, as indicated by the number of housing units (possible weight 20%).

- Performance indicators, such as number of school matriculates, number of tax units for urban property tax, etc. (possible weight 15%).
- Fixed costs incurred by all districts, i.e. a fixed amount per district or possibly varying with land area or number of union councils (possible weight 15%).

6.36 Any revenue sharing formula along these lines will highlight the gross mis-deployment of fiscal resources across districts. Some districts are much better endowed with existing public sector establishment, activities, and spending from the provincial budget than they should be, whereas others are grossly underfunded. The needed adjustment toward spending levels that are determined on a more objective basis will be phased over a transition period. This will also give the districts time to mobilize more revenues for activities which they consider of high priority for continuing funding. Moreover, in the first year or two of implementation, salaries of provincial civil servants working in the new district governments will continue to be paid by the provincial government and will not be included in the provincial divisible pool. While such transitional arrangements cushion adjustment and probably reduce opposition to devolution, they also carry the risk of reducing the effectiveness of devolution and slowing the momentum of change.

6.37 Since devolution represents an opportunity to improve public sector service delivery, Punjab and the other provinces have an important role to play in ensuring that devolution succeeds and leads to better service delivery and outcomes as intended. To facilitate and support devolution, the provinces need to (1) help create fiscal space for local governments through provincial fiscal restructuring; (2) devise appropriate provincial-local fiscal transfer mechanisms and transitional arrangements; (3) restructure and rationalize their civil services in line with the needs of devolution; and (4) effectively handle new roles like providing technical assistance to the local governments, capacity building, monitoring local government financial management and service delivery, and less intrusive regulation. In dovetailing Punjab's reform program with the devolution initiative, certain key issues will need to be resolved: excessive and uneven staffing of provincial civil servants across districts; the province's portfolio of unfinished investment projects; and the existing provincial debt. A sound principle to follow in addressing these legacies from the past would be to avoid putting an excessive fiscal or staffing burden on the local governments but to make sure that they face appropriate incentives for future activities and decisions/investments.

7. CIVIL SERVICE REFORM

Introduction and Overview

7.1 Fiscal restructuring without major improvements in governance, more effective public institutions, and civil service reforms will not be successful or sustainable over the longer term. Punjab's large public sector suffers from serious problems, like other provinces:

- **An overcommitted, overextended public sector** involved in far too many activities, many of which do not fall within the core or desirable roles of government.
- **An ineffective civil service** (discussed in more detail in this chapter).
- **Lack of accountability** for performance, both internally and to the public.
- **Poor management** compounded by very frequent transfers of senior civil servants.
- **Corruption**, which is widely perceived to be a problem by the private sector and general public, and leakages in public spending.
- **Deteriorating and in some cases non-functioning public institutions.**
- **Harassment of the private sector** by provincial government regulatory agencies, leading to high costs and a poor investment climate.
- **Lack of transparency** in public sector activities.

Institutional reforms in selected sectors and in core fiscal and planning departments have been discussed in previous chapters. This chapter focuses on civil service reform more generally.

7.2 Punjab, like Pakistan as a whole, has a large, costly (in relation to available fiscal resources), inadequately skilled, underpaid, unmotivated, and highly centralized civil service, which under previous governments had become highly politicized. Numbering around one million (including employees of provincial autonomous bodies and non-regular staff), the provincial civil service pre-empts 45% of Punjab's total budgetary expenditures for its wages and pensions,¹ compared with 36% a decade ago. The explosion of civil service pension costs (which doubled their share in total budgetary spending doubled during the past decade) is particularly worrisome. With about one-fifth of provincial civil servants in the lowest (unskilled) grade, 41% in the five lowest-skilled grades (out of 22), and numerous staff lacking skills or educational background for their jobs – Punjab's public sector cannot perform existing or anticipated future functions effectively.

7.3 Management of personnel and key decisions on promotions and transfers have been largely centralized at the provincial headquarters level, which is counterproductive particularly in the case of departments responsible for local service delivery (education, health, agriculture, etc.). Internal accountability mechanisms within the largely inward-oriented civil service – ranging from staff performance evaluation to bureaucratic checks against irregularities – have been severely eroded over time. And existing mechanisms for public accountability – such as the Public Accounts Committee, legislative review of the budget, public access to information, complaints mechanisms, etc. – are not working effectively or at all. Pay is low, especially at the higher grades, and corruption appears to be widespread in many departments.

¹ These figures, based on 1999/00 budget data, understate the true cost of the civil service establishment to Punjab. A considerable portion of non-salary recurrent expenditures (utilities, office equipment, fuel, supplies, etc.) supports the civil service and does not contribute to service delivery. Moreover, part the budget for the Annual Development Program covers wage costs of various staff on non-regular contracts. And similarly, part of spending on maintenance and repair (M&R) is for wages of non-regular staff involved in these activities.

7.4 The provincial government has already taken steps to improve financial accountability and strengthen management of the civil service, including through efforts to de-politicize civil service decisionmaking and re-instill merit-based recruitment and transfer practices (including reducing and regularizing the frequency of transfers). The province has recently promulgated legislation enabling mandatory retirement of civil servants after 20 years' service and those found to be corrupt or inefficient. The challenge will be implementing such rules effectively and in a manner that is perceived as fair. Another promising provincial initiative has been to engage in hiring of certain key service delivery staff (most notably doctors) on a contractual, time-bound, facility-specific basis, without eligibility for pension under existing generous terms. The civil service reform agenda is complex and difficult but can build on these and other promising initiatives. Progress will be required on four broad fronts: (1) adjusting the size and skill mix of the civil service; (2) strengthening internal and external accountability; (3) modernizing and decentralizing management; and (4) restructuring civil service pay and pensions.

Establishment Size and Cost

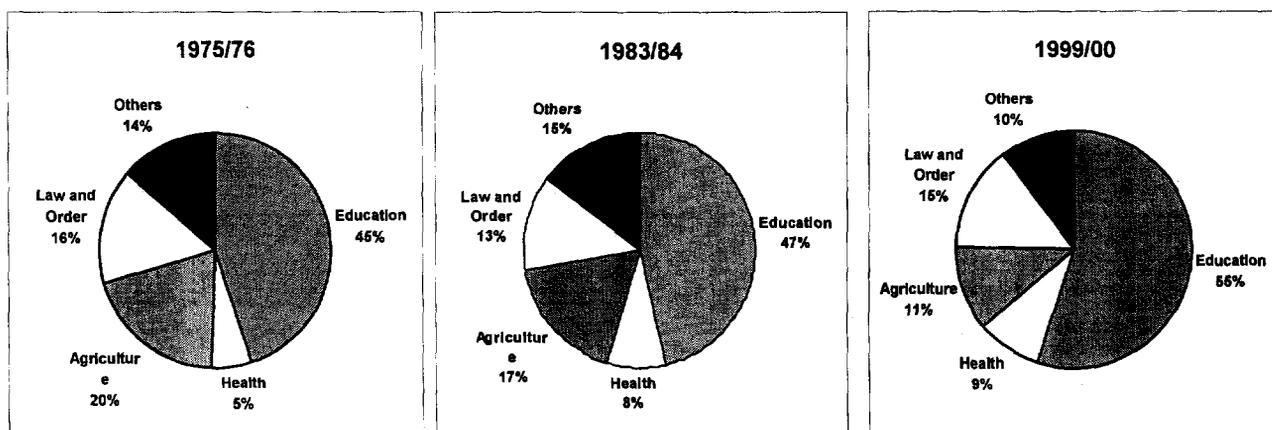
7.5 The Punjab government's large establishment, broadly defined, includes not just the 862,000 sanctioned provincial staff posts as of 1999/00 but also an estimated 100,000-plus employees in the province's 120-odd autonomous bodies. There are also substantial numbers of non-regular staff paid from the budget of the Annual Development Program (ADP) and the maintenance and repair (M&R) budget. Overall, and taking into account the fact that not all sanctioned posts are filled, something like a million persons are employed in one way or another by Punjab's public sector. After rapid growth in the 1970s and much of the 1980s, total government employment in Punjab increased at a steady rate of 2.5% per year in the late 1980s and first half of the 1990s. In recent years public sector employment growth has slowed down, and indeed, the total number of sanctioned posts has stabilized and even declined somewhat. The provincial government is engaged in an ongoing process of gradual right-sizing through natural attrition, abolition of vacant posts, disbanding of inessential organizations, and other similar measures. However, grade creep through the practice of automatic "move-overs" into the next higher grade, significant ad-hoc wage increases, and slower growth of total expenditures (constrained by revenues) have meant that the wage bill has continued to increase its share in total spending. Moreover, civil service pension costs are burgeoning as large cohorts of civil servants retire and will continue to grow rapidly in the absence of any remedial action.

7.6 Considering the wide range of public services that the province is supposed to provide, the ratio of public sector employees to population (1.4%) does not seem high from an international perspective. More than five-sixths of total provincial government employment (in terms of sanctioned posts) is concentrated in education, police, health, and irrigation and agriculture, with 55% in education alone (see Figure 7.1). Moreover, the shares of education and health have been rising over time, reflecting in part efforts to increase provision of basic social services as part of the Social Action Program. Thus the overall sectoral composition of the civil service would seem broadly in line with Punjab's current responsibilities for service provision.

7.7 Both the size and cost of Punjab's establishment are high, however, in relation to available fiscal resources. The civil service wage bill and pensions together account for 45% of the total budgetary expenditures of the provincial government. With interest on the province's debt amounting to another 15%, all remaining expenditures – non-wage O&M and the

development program in particular – have been squeezed.² This situation largely reflects the inadequacy of fiscal revenues in Punjab and more generally in Pakistan as a whole. If the revenue picture does not improve, the province’s wage bill and unfunded pension liabilities are likely to become increasingly unmanageable.

Figure 7.1: DEPARTMENT-WISE COMPOSITION OF SANCTIONED POSTS ^{a/}



^{a/} The Health category includes Health Services and Public Health; Agriculture includes Agriculture, Irrigation, Forests, Fisheries, and Veterinary departments; and Administration includes Police, Administration of Justice, and Jail and Convict Settlements. The largest item in the “Other” category is General Administration (2.6% of the total number of sanctioned posts in 1990/00).

7.8 In addition to the affordability issue, neither the large size nor the cost of the provincial establishment corresponds to the quantity and quality of services actually being delivered to the public. This is evident from analysis of individual sectors and programs (see Chapters 2-5), and from the overall grade composition of the provincial civil service – dominated by lower-grade unskilled and low-skilled positions. A few general observations can be made:

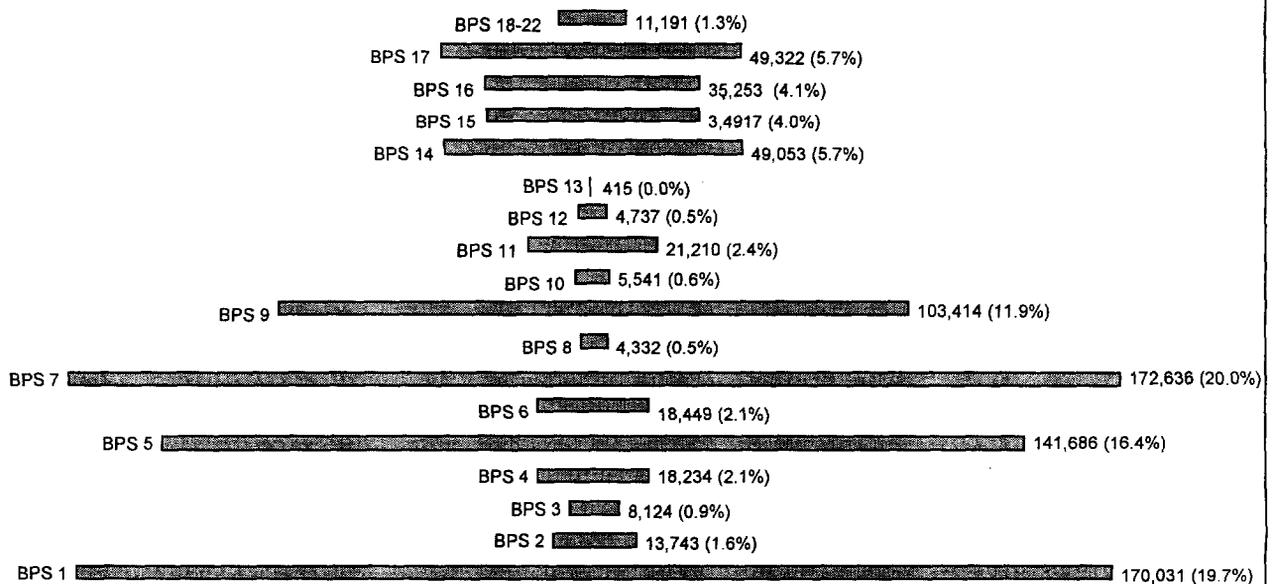
- **Substantial numbers of public sector employees are in agencies whose original mission has disappeared.** More than 4,000 remain in the Provincial Industries Department and its subordinate bodies, even though the province has privatized its industrial concerns. The Punjab Mineral Development Corporation is another good example.
- **Redefining the appropriate roles of government and focusing on essential core functions will inevitably make a number of organizations and sub-units and their employees redundant.** Examples include the devolution of the irrigation system to autonomous organizations and privatization of a number of autonomous bodies.
- **The current grade structure of government posts in Punjab suggests that many staff are not suitably trained or needed for core service delivery functions.** Nearly a fifth of the total number of sanctioned posts in 1999/2000 were in Grade 1 (with essentially no training or skills requirement), and 41% were in the low-skilled Grades 1-5 (see Figure 7.2). Thus a

² Non-wage O&M in support of service delivery is likely to have been particularly squeezed, since a significant proportion of non-wage, non-interest, non-subsidy recurrent expenditures covers the expenses of maintaining the establishment, not directly related to service delivery (e.g. office utility bills, office materials, telephones).

great many provincial government employees are in grades corresponding to skill levels that are inadequate for effective public service delivery.

- **Considerable direct evidence also points to staff with inadequate skills and training serving in jobs for which they are not qualified.** Examples include teachers who cannot pass exams for the subjects they teach, untrained health staff, poorly trained policemen, clerical staff lacking basic computer skills, etc.
- **Excess staffing also arises from duplication and overlapping of organizational roles/functions,** both between provincial and local agencies and within the provincial apparatus. Examples include the development authorities and municipal corporations and the various departments and bodies involved in civil works.

Figure 7.2: GRADE STRUCTURE OF SANCTIONED POSTS, 1999/00



Note: BPS stands for Basic Pay Scales. Grades 18-22 also includes unclassified sanctioned posts.

7.9 The evidence thus strongly suggests that there is considerable need and scope for reducing the numbers of civil servants lacking appropriate qualifications and skills. On the other hand, needed skills are in short supply in many areas – appropriately skilled management personnel in the basic social sectors, for instance. Some cost savings should be possible, however. Abolishing the significant number of unfilled sanctioned posts would be a relatively easy measure to contain the establishment size and prevent future increases. In fact, Punjab has reduced the number of sanctioned posts by more than 36,000 during the last year or two. There would be immediate savings if the posts of retiring civil servants are abolished as they retire. Over time, as successful staff reductions in Pakistan Railways have shown,³ reductions in staffing based on natural attrition can be very substantial. Attrition-based staff reductions need to be carried out as part of a broader reform effort, however, to avoid possible negative effects on

³ The Railways Ministry sharply reduced its sanctioned staff strength from 134,000 in 1999 to 93,000 by March 2001, through elimination of vacant posts and “ghost workers”, better work discipline (i.e. enforcing staff attendance, which encouraged some employees with multiple jobs to leave voluntarily), and natural attrition.

service delivery. Some unfilled sanctioned posts in critical areas should be filled by appropriately qualified and skilled people rather than eliminated. Although natural attrition is a relatively painless way to downsize, it will not itself produce an appropriate distribution of the remaining public sector employees. Moreover, given the acute fiscal squeeze, the need to bring in new staff with appropriate skills, and very low turnover rates in Punjab's civil service, unmanaged natural attrition alone is unlikely to achieve needed structural changes within a reasonable time period.

Incentives, Accountability, and Management

7.10 In addition to lacking many of the skills needed to provide quality public services that are in demand, the civil service in Punjab, as well as in Pakistan, faces weak or inappropriate incentives which constitute a major constraint on its effectiveness. Both internal and external accountability have been severely eroded over time, and management structures and processes are outdated. The extensive and detailed rules that cover personnel management process – recruitment, promotions, pay increases, transfers, and retirement – are in urgent need of streamlining and modernization. Honored largely in the breach and eroded by political interference, the procedures tend to be mechanical, inward-oriented, primarily based on seniority, and unrelated to performance, particularly as perceived by the public.

7.11 One of the most notable manifestations of these problems is absenteeism, particularly at crucial service delivery points. Doctors and other trained medical personnel frequently do not show up at rural health centers or higher-level facilities, many teachers are not on the job for various reasons, agricultural extension personnel frequently provide no service to the ordinary public, etc.⁴ The frequent practice of arranging through political or other connections transfers from undesirable postings to better locations (mostly in the cities) is a form of approved absenteeism that has contributed to massive mis-deployments of service delivery personnel across localities. Even when public sector employees are on the job, anecdotal evidence suggests that they often spend time away from their station or not working.

7.12 Another manifestation of the problems described above is corruption, which appears to be widespread in some provincial agencies like the police, taxation, and works departments. This imposes a direct financial burden on those trying to gain access to government services, but more important it imposes large costs in time required and associated uncertainty, distorts decisionmaking, and erodes the credibility of the public sector. Complex, time-consuming regulations and procedures provide opportunities for corrupt practices, which highlights the importance of deregulation to improve governance. Autonomous bodies, with weak oversight of their activities and finances, also provide opportunities for corruption.

7.13 The factors responsible for these problems include, among others, the following:

- **Low pay at all levels, discouragingly low for those with sought-after skills.**
- **Lack of accountability for performance.** The civil service has been inward-oriented, but established internal accountability mechanisms – ranging from staff performance evaluation to bureaucratic checks against irregularities – have been severely eroded over time. Existing mechanisms for public accountability – such as the Public Accounts Committees, legislative

⁴ Although reliable system-wide data on absenteeism are not available, the Third Party Validation Report by the Auditor General of Pakistan has found that in the social sectors, systems for monitoring and discouraging absenteeism were not in place in many local offices, especially in the case of education.

review of the budget, public access to information, complaints mechanisms, etc. – are not working effectively (or at all in some cases).

- **Erosion of internal management controls;** For example, inspection visits by supervisors have been rare and often only cursory, and monitoring of absenteeism is non-existent in many cases.
- **Lack of effective sanctions for poor performance or irregularities.** There were only 102 convictions for irregularities of all kinds in anti-corruption courts during the entire period 1985-1999, a small number in view of the size of the provincial civil service and indications of widespread corruption. Moreover, the conviction rate among cases decided by anti-corruption courts was only 18%, and long delays were very common.
- **Raises and promotions unconnected to performance.** The vast majority of promotions are on the basis of seniority, with the practice of virtually automatic “move-over” into the pay scale of the next higher grade further diluting any performance incentive.
- **Recruitment becoming, in a politicized environment, a very important (and frequently abused) reward mechanism, while postings and transfers have been improperly used as major instruments for reward and punishment.**

7.14 Punjab has made a promising start at improving discipline in the civil service and imposing meaningful penalties for irregularities. The revised Efficiency and Discipline (E&D) Rules 1999 and Punjab Removal from Service (Special Powers) Ordinance 2000 are intended to facilitate expeditious disposal of disciplinary proceedings. So far more than 19,000 disciplinary cases have been initiated under the new Ordinance, of which nearly 15,000 have been finalized. Major penalties include 2,889 dismissals and 1,274 demotions. Such improvements in discipline are welcome but need to be complemented by sustainable enhancements in accountability as well as positive incentives.

Devolution and the Civil Service

7.15 Pakistan’s bold devolution plan has profound implications for the provincial government’s roles, organizational structure, and establishment. By bringing management of localized public services close to the beneficiaries, devolution creates the potential for much greater beneficiary participation and monitoring that can promote more responsive and accountable performance. Devolution also provides an opportunity to restructure the province’s civil service in line with decentralized management and service delivery needs. There are over 770,000 sanctioned staff positions in provincial departments responsible for agriculture, irrigation, public works, health, education, literacy, commerce and industries, communications, police, and magistracy. If even half of these employees are transferred to the local governments, there will be massive change.⁵

7.16 Devolution also carries risks, some of them serious. At one extreme, devolution might be stifled if the provincial bureaucracy remains pretty much as it is, with officials nominally assigned to local governments but still reporting to their superiors in provincial departments, and personnel management, career development, etc. remaining centralized. On the other hand, wholesale transfer of provincial employees to local governments, in the absence of any other

⁵ While some of these departments have sections which are likely to remain at the provincial level, on the other hand the bulk of employees in elementary schools and basic health units will be working at the local level. Thus the assumption that half of the total number of staff in these departments would be affected by devolution is probably conservative.

actions, could saddle the latter with huge liabilities and threaten their viability. These considerations suggest that careful planning and appropriate sequencing of all of the interacting civil service changes related to devolution is very important.

7.17 There are also issues related to the status, management, and incentive orientation of civil servants. For devolution to deliver the greatest positive impact, the local and provincial administrative structure and staffing needs to be made consistent with devolution. If legal constraints so require, the formal status of provincial government staff as provincial civil servants could be left unchanged when they are initially transferred to local governments. However, their reporting relationships, performance evaluation, and personnel management should be with the local governments they serve. There need to be provisions, however, for cross-district mobility for well-trained, highly skilled staff and those with potential for advancement. Moreover, until adequate accountability mechanisms at the local political level are in place and well-tested, it may be wise to retain a certain degree of provincial connection for top-level local bureaucrats such as the District Coordinating Officers, to provide some checks and balances against misuse of authority and funds by local politicians and to help minimize problems of political patronage and corruption during the transitional period.

7.18 Mis-deployment of provincial service providers (most notably teachers and health personnel) across localities will create serious problems for the new district governments unless corrected. It would be best to substantially resolve this problem prior to the transfer of these staff to the local governments, or at least stipulate that staff who turn out to be surplus at the district level would be retained by or returned to the provinces for ultimate disposition.

7.19 In sum, improvements in the civil service at both provincial and local levels will be critical for the success of Pakistan's devolution initiative. Devolution will not make a positive difference over the longer term without a local government administration that works and is responsive to the needs and demands of the local population. This will require establishing local government administrative structures and guidelines, capacity building and training for local civil servants, and moving toward incentives and civil service structures that are fully consistent with the spirit of devolution – empowerment of elected local governments, meaningful accountability to the local population, local government management of local public services, decisionmaking at the local level for maximum responsiveness to local needs, and so on. Establishment of performance measurement and monitoring systems will be critical for the success of devolution. The people and their local representatives need to receive good information about the inputs, outputs, and outcomes of local public services. Comparative information in particular may lead to healthy pressure for improvements (for example if parents see their children making less educational progress than those of neighboring villages).

Reform Options

7.20 Reforming and restructuring Punjab's civil service to achieve better service delivery, in line with devolution, will be a complex, difficult task, with pitfalls along the way. Reforms need to be based in the first place on a clear and focused delineation of the core roles of government. Progress will be required on four broad fronts: (1) adjusting the size and skill mix of the civil service; (2) strengthening internal and external accountability; (3) modernizing and decentralizing management; and (4) restructuring civil service pay and pensions. These reform components have both short- and longer-term dimensions. International experience does not suggest that trying to tackle all of these aspects quickly and at once for the entire civil service (a

“big bang” approach) would have good prospects for success. However, short-term actions need to be informed by a longer-term perspective and vision, and significant progress over time in critical areas will be essential. There also needs to be a strong effort to ensure overall consistency of different civil service changes and appropriate sequencing of reform measures. Reform design and implementation need to rely heavily on feedback from the intended beneficiaries of government services. Civil service reform should not be viewed as a central planning exercise but rather kept focused on the key objective of improving service delivery. Reform options in the four main areas of civil service reform are discussed below.

7.21 **Adjusting the size and skill-mix of the civil service.** In the near-term, civil service restructuring could include the following key components:

- **Identify core public sector roles and activities** – which services to provide, which only to fund in part or in full, and which to drop entirely. This exercise could start with setting overall directions and priorities and then get into specifics for particular agencies.
- **Set meaningful, realistic objectives for public service delivery** in the core areas.
- Based on these objectives, **ascertain staffing needs for delivery of core public services and management of these activities** – both the numbers of persons needed in different broad categories and the skills required.
- **Assess the current provincial establishment in the light of devolution and in relation to staffing and skill mix needs** to bring out inconsistencies and major disconnects.
- **Develop and cost different options for addressing these disconnects.** Voluntary retirement schemes, if they are considered as an option, need to be at reasonable cost and cannot be solely at the discretion of staff, to avoid problems of adverse selection.
- As noted earlier, restructuring should also include **improving the skills of existing staff** wherever possible to meet present and future demands, and **bringing in needed skills** where they are not available or achievable through internal training.

7.22 A restructuring program along these lines should not have as its main objective reduction of the wage bill or employment, but rather to improve the effectiveness of the public sector through focus on essential core functions. Identifying essential areas of operation and realistic objectives for performance is a job that, as interested parties, government agencies and departments should not perform alone. Independent professionals should be involved in the assessment of provincial departments and agencies, along with knowledgeable insiders.

7.23 Over the longer run, the leaner size and better skill structure of the civil service will need to be put on a sustainable basis, which will require progress with the other components of civil service reform, discussed below, as well as regular reviews and adjustments of staff size and skill composition in relation to identified objectives and needs. Relevant training to upgrade the skills of existing civil servants should be an integral component of civil service restructuring, although unrealistic expectations should not be placed on training – for example, it will be impossible to train illiterates to become clerks or computer operators, staff lacking a reasonable educational background of their own to become teachers, and so on.

7.24 **Strengthening internal and external accountability.** Accountability, a crucial ingredient of good governance, has been lacking. External accountability mechanisms need to be restored and strengthened, and new instruments can be developed to further enhance accountability to the public. Credible complaint mechanisms and public monitoring arrangements, for example for the police, would be very beneficial. Another promising option is

public sector scorecards on service delivery at the local level. These accountability mechanisms will require appropriate performance targets and incentives, good information flows, meaningful feedback, and careful monitoring. Comparisons between service delivery performance in different areas and services can be particularly illuminating. Devolution will open up additional channels for enhancing accountability to the public, through local government representatives and councils at different levels, citizen community boards, facility-based beneficiary monitoring, etc. Greater transparency of budget documents (suggested earlier) and regular reports to the public on the budgetary situation also will promote public accountability. Performance budgeting needs to be further developed, building on Punjab's pilot initiative but with only a few key targets/indicators and more systematic monitoring of outcomes. Timely, substantive review of audit reports by the provincial ad-hoc Public Accounts Committee, already being initiated, and meaningful follow-up will help promote external accountability. More generally, transparency needs to be enhanced by making detailed information on the public sector and its performance available to the public. Punjab has made a good start in this regard by establishing a website.

7.25 Strengthening internal accountability within the civil service also is essential. The federal government has taken some important steps in this regard, which provide an example for Punjab and other provinces to consider following. Most notably, the Federal Public Service Commission (FPSC) has been strengthened and given greater autonomy by eliminating the government's right to withdraw any post from the purview of the Commission and by appointing its Chairman and members on fixed, non-extendable, five-year terms. Such reforms also could be taken up in the Punjab Public Service Commission. Punjab has promulgated ordinances similar to those of the federal government enabling mandatory retirement of civil servants after 20 years of service and those found to be inefficient or corrupt. The challenge will be implementing such rules effectively and in a sustained manner. Punjab is already working on strengthening the annual performance review process for staff, which needs to be much more job-related and performance-oriented. And finally, strong efforts are needed to fight corruption, an extreme manifestation of lack of accountability. Combined with improving procedures and increasing its capacity, the provincial anti-corruption department may need to be given a higher profile in the provincial bureaucracy.

7.26 **Modernizing and decentralizing management.** In order to become more effective, Punjab's civil service needs to modernize its management structure, rules and regulations, and terms and conditions of employment. The extensive and detailed rules that cover the entire gamut of personnel management processes – recruitment, promotions, pay increases, transfers, and retirement – need to be reviewed, streamlined, and modernized. While such a review should be thorough and credible (involving knowledgeable outsiders) and will take time, some possible reform options can be put forward for consideration.

- **A comprehensive civil service Census is urgently needed** to generate reliable information on the size and structure of Punjab's public sector in terms of employment. The Census would need to include employees of the autonomous bodies and non-regular staff.
- **De-politicize the recruitment process and make it merit-based and transparent**, by strengthening the Punjab Public Service Commission and making it more autonomous, and by giving it the authority for recruitment of all civil servants above a certain level.
- **Hire most new staff on time-bound contract basis**, for work at a specific facility or locality wherever appropriate and feasible. Such a new employment system could apply for all low-grade staff (BPS 1-4), all doctors and teachers, agricultural extension personnel, and most

other staff except for key agencies like the police, judiciary, tax administration, etc. Safeguards need to be put in place to prevent contract employees from being regularized by a future government; the risk of such an eventuality will be reduced if contract appointments are made on a facility-specific or localized basis.

- **Existing rules on minimum time in post should be enforced** to minimize the scope for politicized and corruption-related transfers.
- **Contract out non-core activities** to private firms or individuals wherever possible and appropriate.
- **Revise performance evaluation (Annual Confidential Review) forms and processes** to make them more forward-looking, transparent, participatory (including the staff concerned), and performance-based. New performance evaluation forms have recently been introduced at the federal level, which could provide guidance for Punjab in this effort.
- **Phase out rigid compartmentalization of different civil service cadres** and outdated service rules.
- **Decentralize management and give more flexibility and authority to managers of facilities and service providers** to respond as they see best to local needs and demand, subject to accountability for performance.

7.27 In sum, it should be possible to revive and strengthen good civil service management practices and shift them toward a more decentralized, outward-oriented, client-focused basis. Merit should be evaluated (and rewarded) on the basis of performance in serving clients.

7.28 As discussed earlier, one of the most serious adverse effects of bad governance is the burden of regulatory harassment on the private sector, which raises costs and discourages investment. Much regulation is implemented at the provincial level. Private sector surveys suggest that frequent visits by factory inspectors monitoring various regulations (labor, safety, health, environmental, etc.) are a significant source of corrupt payments and wastage of management time. A top priority would be to conduct a thorough assessment of existing provincial laws and regulations and how they are implemented, with a view to identifying those which are unnecessary or misused and in need of change. Implementation and enforcement need to be improved to minimize the scope for harassment and extortion. For example, inspectors' visits could be limited in number and coordinated in their timing, greatly reducing the number of interactions between individual inspectors and business firms.

7.29 **Restructuring civil service pay and pensions.** Punjab and the other provinces traditionally have followed the lead of the federal government on civil service terms and conditions of employment, including pay and pensions. This pattern undoubtedly will continue. However, there is a need for greater flexibility at the provincial and particularly (with the new local governments becoming operational soon) local levels. The provinces and local governments will need to move away from a "one-cloth-fits-all" approach and introduce different terms and conditions, pay levels, tenure, etc. for different types of jobs. Although appropriately qualified and skilled people are often grossly underpaid in the civil service, pay increases need to be based on fiscal and performance considerations and appropriately sequenced with other changes in the civil service. Containing future pension liabilities is an urgent priority. Some options for restructuring civil service pay and pensions are sketched out below.

7.30 At a very basic level, improving and computerizing payroll systems would provide much better information on the wage bill and staffing, and will facilitate identifying and weeding out “ghost employees” and absentees. This is a very important reform with a high pay-off.

7.31 The reduction in rates of pay in real terms for senior levels in the civil service as compared with the private sector, and the compression in civil service pay scales that has occurred over the years, have become a serious problem, making it difficult to attract well-qualified people to higher levels in the civil service on the basis of salary alone. The extra perquisites that go to senior officials (housing, vehicles, personal staff, etc.) are distortionary as compared with cash benefits and are also non-transparent. Moreover, egregiously low pay at the upper levels increases the incentives to engage in corrupt practices. Thus a widening of the spread in pay scales is called for, with particular emphasis on highly qualified managers and technical experts. This could be combined with monetization of some perquisites to enhance transparency of the civil service pay structure. The provincial government has introduced new pay scales for contractual appointments carrying market-related salaries, which is a step forward in this regard.

7.32 Pay increments for civil servants need to be more performance-based – at least contingent on satisfactory performance – and the practice of automatic “move-over” into the next higher grade needs to be stopped. If necessary, this change could be accompanied by an increase in the number of steps within each grade, so that staff at any given grade level would get (probably smaller) increments over a longer period of time.

7.33 The explosion of civil service pension costs and the “time bomb” of future pension liabilities urgently need to be contained. Options for making progress toward this end include:

- **A thorough survey to weed out “ghost pensioners”** – i.e. pensioners who do not exist or who have died and are no longer eligible for pensions for themselves or their families.⁶ (The provincial government is conducting a survey along these lines, with the help of district governments.)
- **Putting all new civil servants onto a funded, partly contributory pension scheme** with specifically limited fiscal costs. (The provincial government is working on the modalities of a Contributory Provident Fund scheme to serve in place of pension for new employees.)
- **Modifying the unaffordable practice of undiscounted commutation of up to half of each civil servant’s pension entitlement.** (The federal government is considering a package of measures developed in consultation with the provinces to rationalize civil service pensions.)

7.34 Reforms in the area of civil service pay and pensions would need to be carefully designed and implemented in close partnership with the federal government, with the federal government taking the lead in most areas. However, there are important actions that Punjab and the other provinces can take – like computerizing the payrolls, ridding the rolls of “ghost pensioners”, introducing and funding a new pension system for new recruits, and contracting out non-core services – that would make a real difference in containing establishment costs and improving the provincial public sector’s effectiveness and efficiency.

⁶ In the case of the Railways, around 18,000 ghost pensioners were found and were eliminated from the rolls, saving a substantial amount of money.