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Pakistan

Social Protection in Pakistan

Managing Household Risks and Vulnerability

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ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
CCT	Conditional Cash Transfer
CSP	Child Support Program
DFID	Department for International Development (UK)
DPO	Disabled People's Organization
EOBI	Employees Old Age Benefits Institutions
ESSI	Employees' Social Security Institutions
FSP	Food Support Program
GDP	Gross Domestic Product
GoP	Government of Pakistan
GNI	Gross National Income
GPF	Government Provident Fund
HIES	Household Income and Expenditure Survey
IFA	Individual Financial Assistance
ILO	International Labor Organization
MF	Microfinance
MFI	Microfinance Institution
MTDF	Medium Term Development Framework
NCsRCL	National Centers for Rehabilitation of Child Labor
NFWP	North-West Frontier Province
NGO	Non-Governmental Organization
PBM	Pakistan Bait-ul-Mal
PIHS	Pakistan Integrated Household Survey
PPAF	Pakistan Poverty Alleviation Fund
PRHS	Pakistan Rural Household Survey
PRSP	Poverty Reduction Strategy Paper
PSLM	Social & Living Standards Measurement Survey
PSNS	Pakistan Safety Net Survey
PWD	Person(s) with Disabilities
RCPD	Rehabilitation Centre for the Physically Disabled
RSP	Rural Support Programs
SP	Social Protection
SRM	Social Risk Management Framework
VDG	Vulnerable Group Development
WWF	Workers Welfare Fund

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Contents

Executive Summary	i
Chapter 1. Introduction.....	1
I. Why This Report and Why Now?.....	1
II. What is Social Protection?.....	2
Chapter 2. Identifying The Neediest And Most At Risk: A Profile Of Poverty And Vulnerability 7	
I. Introduction.....	7
II. Poverty, Risk and Vulnerability.....	8
III. Poverty and Vulnerability profile	16
IV. Informal Risk Management Strategies.....	21
V. Conclusions.....	27
Chapter 3. Fighting Poverty and Vulnerability: Pakistan’s Social Protection System.....	29
I. Introduction.....	29
II. Pakistan’s Social Protection System: A Brief Overview	30
III. Safety Nets: Providing Income and service support for the Poor	33
IV. Providing Insurance through Social Security	69
V. Challenges ahead for Pakistan’s Social Protection system.....	78
Chapter 4. An Agenda for Better Social Protection	80
I. Introduction.....	80
II. Toward a Comprehensive Social Protection system.....	81
III. Specific Options for Program Design, Financing, and implementation	83
IV. Conclusions.....	101
Bibliography	102

Tables

Table 2.1: Incidence and Nature of Shocks	10
Table 2.2: Coping with shocks can be a high share of household expenditures.....	12
Table 2.3: Children withdrawn from school or put to work in response to shocks	13
Table 2.4: Type and Incidence of Vulnerability	15
Table 2.5: Key Labor Market Indicators for Pakistan (2003/04).....	18
Table 2.6: Coping Strategy by Nature of Shock.....	22
Table 2.7: Use of Coping Strategies across Households	22
Table 2.8: Adequacy of Private Assistance	27
Table 3.1: Spending and Beneficiaries of Main Social Protection Programs (2003/04)	32
Table 3.2: Overview of Zakat programs (2003/04)	36
Table 3.3: Distribution of benefits and beneficiaries.....	39
Table 3.4: Targeting performance of cash transfers in Pakistan and internationally.....	40
Table 3.5: Distribution of PSNS Phase I sample by program status and quintile	40
Table 3.6: Average household income according to program presence	41
Table 3.7: Adequacy of program benefits.....	42
Table 3.8: Pakistan Bait-ul-Mal expenditures, by subprogram	45
Table 3.9: Combined expenditures by Zakat and Bait-ul-Mal	47
Table 3.10: Coverage by religion and sect.....	48

Table 3.11: Budget for federally implemented social care services, 2003/04	52
Table 3.12: School attendance and receipts of free textbooks, by sector, quintile, and program status	63
Table 3.13: Overview of Private Sector Social Security Programs	71
Table 3.14: Financing of Social Security	73
Table 3.15: Coverage of EOBI, 2005	74
Table 3.16: Number of beneficiaries receiving cash benefits, ESSi and EOBI, 2004	77
Table 4.1: Overview of main programs, target groups, and expected outcomes	83
Table 4.2: Fiscal resources and the poverty gap	84
Table 4.3: International experience with extending pension coverage to informal sector	100

Figures

Figure 1.1: Most countries spend more on social insurance than on social assistance (percent of GDP)	6
Figure 2.1: Poverty headcount in recent years	9
Figure 2.2: Poverty headcount, by province	9
Figure 2.3: Vulnerability headcount	16
Figure 2.4: Vulnerability by household characteristics	17
Figure 2.5: Vulnerability by education and employment	18
Figure 2.6: Education outcomes	20
Figure 2.7: Child Health Outcomes	20
Figure 2.8: % Safety net recipient/applicant households experiencing food shortages as a result of shocks	26
Figure 3.1: Spending on social protection in South Asia	31
Figure 3.2: Federal Government Subsidies, 2004/05-2006/07 (Rs. Million)	33
Figure 3.3: Most subsidies are for power and water (2005/06)	33
Figure 3.4: Zakat revenue, in real and relative terms, 1980-2003	38
Figure 3.5: Waiting time for obtaining Zakat	44
Figure 3.6: Average waiting time between guzara payments	44
Figure 3.7: Number of Bait-ul-Mal beneficiaries, 1997/98-2006/07	46
Figure 3.8: Bait-ul-Mal's revenue and expenditures, in real and relative terms, 1992-2006	47
Figure 3.9: Average waiting time between FSP payments	50
Figure 3.10: Coverage of microfinance in South Asia	57
Figure 3.11: Fiscal cost of wheat subsidy	67
Figure 3.12: Real minimum pension paid by EOBI, 1987-2005	74
Figure 3.13: Incidence of different social security benefits by quintile	75
Figure 3.14: Administrative costs as share of benefits and contributions in EOBI, 1993-2003	77

Boxes

Box 1.1: An Overview of the new Pakistan Safety Net Survey	3
Box 2.1: The Earthquake of October 8, 2005	11
Box 2.2: Regional and international evidence on the incidence and impact of shocks	13
Box 2.3: Measuring vulnerability – A brief methodological explanation	14
Box 2.4: Labor market outcomes in Pakistan	19

Box 2.5: Education and Health Outcomes in Pakistan	20
Box 2.6: Coping with multiple misfortunes – The story of Tariq	24
Box 2.7: Child labor as a coping strategy – The story of Rukhsana.....	25
Box 3.1: Fiscal expenditures on price subsidies are substantial, but do not provide social protection	33
Box 3.2: Zakat in other countries.....	34
Box 3.3: Zakat for health care.....	35
Box 3.4: Corruption and patronage in Zakat	37
Box 3.5: Cash versus in-kind Transfers	51
Box 3.6: Disability in India.....	54
Box 3.7: Earthquake social protection response	55
Box 3.8: Bangladesh: Vulnerable Groups Development Program	56
Box 3.9: Moving from Income Support to Self-Employment	58
Box 3.10: Workfare Programs: Experience from Argentina and India	61
Box 3.11: Conditional Cash Transfer Programs – Mexico’s Progresa Program	62
Box 3.12: Bait-ul-Mal is Piloting a Conditional Cash Transfers in Pakistan	64
Box 3.13: School Meals – International Evidence.....	65
Box 3.14: Responding to the Earthquake of October 8, 2005	68
Box 4.1: Setting Benefits Levels – Balancing Adequacy and Incentives.....	85
Box 4.2: Proxy Means Testing – A promising approach to targeting cash transfers.....	88
Box 4.3: Promoting Access to Microfinance.....	90
Box 4.4: How to design workfare?	93
Box 4.5: Phasing out the wheat subsidy	94
Box 4.6: Targeting systems.....	96

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EXECUTIVE SUMMARY

I. Introduction

1. **After stabilizing the economy, Pakistan has realized strong economic growth and reduced poverty.** Economic growth accelerated from 4.8 percent in 2002/03, 6.4 percent in 2003/04, and 8.4 percent in 2004/05, to 6.6 percent in 2005/06. Poverty rates have declined in response, from about 33 percent of households in 2002/02 to 24-29 percent in 2004/05, depending on choice of deflator.

2. **The resurgence of the economy provides the opportunity and the fiscal space to focus on protecting the poor and vulnerable.** Although economic growth is the main vehicle for poverty reduction, international evidence suggests that not all groups benefit equally or immediately from growth. Poor and non-poor alike also remain vulnerable to individual level risks such as health, disability and unemployment, and to community-wide shocks such as natural disasters. Recent economic growth in Pakistan (and the South Asian region as a whole), has been accompanied by growing inequality and has not provided immunity from shocks. The earthquake, which struck the northern parts of the country on October 8, 2005, as well as a series of droughts in previous years, have demonstrated the vulnerability of the country to natural disasters and placed vulnerability center-stage as a major policy concern.

3. **Well-designed social protection policies and programs can complement growth by promoting equity and facilitating risk management.** There are two main social protection instruments (i) *safety net (or social assistance)* programs such as income support (cash transfers, conditional cash transfers, workfare), and social welfare services (e.g., community-based rehabilitation); and (ii) *social security* programs, financed mainly by individual contributions, that help protect individuals (poor and non poor alike) against loss of income due to old age, disability, sickness, or unemployment, and thereby avoid falling into poverty.¹ The mix of programs chosen by any particular country depends on country specific circumstances, including level of income and administrative capacity.

4. **The government's poverty reduction strategy (PRSP) has recognized the vital role of social protection programs as its fourth pillar.** The strategy document recognizes the importance of social protection to complement growth. It acknowledged that the efficiency of social protection programs being implemented in Pakistan was not well known and called for an in-depth study that would evaluate the ability of these programs to protect the poor and provide options for improving their effectiveness.

5. **At the request of the Government of Pakistan, this report evaluates the country's social protection system and suggests improvements in their ability to protect the poor.** Specifically, the study (i) presents a poverty and vulnerability profile to identify the main challenges to be addressed by social protection (Chapter 2); (ii) reviews programs, paying attention to their capacity to address these challenges (Chapter 3); and (iii) proposes a policy agenda for a more efficient and effective social protection system in Pakistan (Chapter 4). A brief introductory chapter (Chapter 1) precedes the main chapters of the report.

¹ World Bank (2005j) and World Bank (2002b).

6. **The report is the result of an inter-institutional collaborative effort between the Government of Pakistan, civil society, and international donors.** A social protection steering committee, comprised of the above stakeholders, oversaw the report's preparation, including surveys, and vetted initial findings. The Planning Commission and the Steering Committee hosted several workshops in which initial findings of the report were discussed with a broad range of stakeholders. The initial findings and diagnostics have also helped inform the new (draft final) national social protection strategy. The report draws on existing knowledge and original work, and is based on administrative and survey data², including a new special-purpose safety net survey, commissioned specifically for the report and conducted under the guidance of the Steering Committee for Social Protection. This survey, referred to in the text as the Pakistan Safety Net Survey (PSNS) has two parts. The first part, referred to as PSNS (I) in the report, is a nationally representative data set that includes information on the coverage of safety net programs, while the second part of the survey, PSNS II, is based on a purposive sample, representative of safety net recipients and applicants (actual and potential), and provides information, *inter alia*, on program delivery as well as shocks and coping strategies for this specific household group (see Appendix 1 for details).

7. **This report finds that while Pakistan implements a wide array of social protection programs, the effectiveness of these programs could be significantly improved.** The report finds that social protection programs in Pakistan face important constraints in terms of coverage, targeting, and implementation, and inability to respond to vulnerability, which will need to be overcome in order that they can more effectively protect the poor. The report suggests a two-pronged approach for social protection reform: (i) improving the ability of safety net programs to reach the poor, promote exit from poverty, and respond to natural disasters; coupled with (ii) a longer term approach for strengthening social security. Considering social protection as a system rather than a collection of different programs would allow the government to curtail fragmentation, improve the quality of social protection spending, and have higher impact. Given fiscal constraints, the report suggests that coverage expansion first exploits the opportunity for efficiency improvements in current programs, through better targeting and reduction in duplication and overlap. However, the decline in real spending on the two main safety net programs is worrisome.³ It is therefore welcome that the government is considering how best to ensure adequate yet fiscally affordable spending on safety nets as part of its draft social protection strategy. A well-designed and -implemented system would allow the Government, consistent with its Poverty Reduction Strategy, to promote growth that would be underpinned with greater equity and security against risks.

8. The remaining sections summarize the main findings and conclusions of the report.

II. Identifying the neediest and most at risk: a profile of poverty and vulnerability

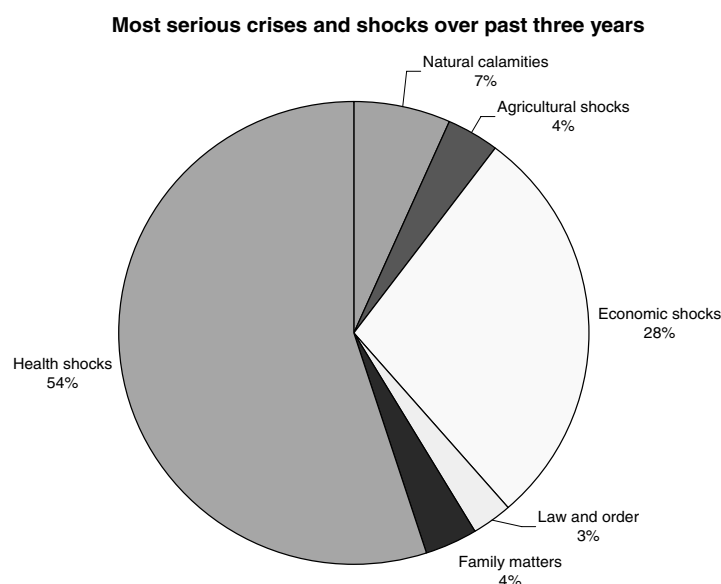
9. **As noted above, poverty has declined sharply in Pakistan, but a considerable agenda in addressing poverty and vulnerability still remains.** Poverty still affects over a quarter of the country's population, and vulnerability estimates suggest that many more households, approximately 56 percent of the population were vulnerable to remain or fall into poverty within a two-year horizon (2002/02 PIHS data). Half of this burden stems from vulnerability to chronic poverty (i.e., low consumption), while the other half is associated with vulnerability to transient poverty (i.e., exposure to risk and variation in consumption levels). Poverty and vulnerability levels are highest among rural households, particularly

² The main surveys used include: (a) Pakistan Integrated Household Survey (PIHS - 2001/02 and other years) and Social and Living Standards Measurement Survey (PSLM - 2004/05), both of which are nationally representative; and (b) the Pakistan Safety Net Survey (PSNS) in which part I is nationally representative while part II is representative of safety net beneficiaries and applicants.

³ Spending on the two main safety net programs, Bait-ul-Mal and Zakat, declined from 0.4 percent of GDP in 1991-92 to 0.15 percent of GDP in 2004/05 and 0.14 percent of GDP in 2005/06.

those employed in the agricultural sector or those with no access to land or other productive assets, and among large households and children. They are also positively correlated with low human capital, making the low level and high inequality of health, nutrition, and education outcomes in Pakistan particularly worrisome as they contribute to perpetuate intergenerational poverty. Thus, in addressing welfare, it is useful to factor in both poverty and vulnerability to poverty.

Figure 1: Shocks faced by safety net recipients and applicants



Source: Safety net survey (PSNS II)

10. **What kinds of shocks affect Pakistani households?** A special survey of safety net recipient/applicant households⁴ found that nearly two-thirds of respondents (about 80 percent of whom were poor) suffered from one or more major shocks in three years before the survey. While this survey was not nationally representative it gives an indication of the shocks that potentially affect Pakistani households. Specifically, over half of all shocks to this group (58 percent) were caused by individual specific factors, mainly health (e.g., death, sickness, disability) or family matters (Figure 1). The remaining (42 percent) shocks were community specific: natural calamities including drought (30 percent), economic shocks (10 percent) and law and order (2 percent).

11. **Shocks impose major costs on both poor and non-poor among surveyed households.** Survey respondents, especially the poorest, face considerable shock-related losses and expenses. Conditional on a shock, losses and expenses due to shocks represent 54 percent of annual consumption for ultra-poor respondent households compared to 27 percent for near poor households and 18 percent for non-poor households. These figures suggest that the potential impact of shocks can be devastating both in the short and the long term.

12. **Surveyed households employed several strategies to cope with risks.** Households rely largely on *asset-based strategies* (using savings/assets—28 percent, or credit—25 percent) and less on *behavioral*

⁴ These results presented in paragraphs 10-14 are derived from PSNS II, a representative sample of safety net recipients/applicants, and not nationally representative. The sample is predominantly poor. Over half of the sampled households (54 percent) are ultra poor (those with consumption below the food poverty line), about a quarter (23 percent) are poor (between the food and national poverty lines), while the remaining were non-poor. (See Appendix 1 for a detailed discussion of the sample).

strategies (decreasing consumption—1 percent, increasing labor supply, or relying on public and private assistance—10 percent) to cope with shocks. A surprisingly large share of households (25 percent) are inactive or ‘do nothing’ in the face of shocks. Use of asset-based strategies is more common under law and order shocks. In contrast, increased labor supply is used more often for family-related shocks, with both strategies important for health shocks. More informal strategies—using savings, shopkeeper credit, help from friends and relatives—are more common for less costly shocks. More formal strategies—selling major assets, borrowing from a moneylender, requesting government assistance—are used for more costly shocks, where more resources are needed.

13. **Inefficient risk coping strategies sometimes lead these households into deeper poverty.** Looking among the poor and non-poor among this specific sample of households, the non-poor, with likely greater access to markets, are more likely to use asset-based strategies while the poor are more likely to use behavior-based strategies. Because there are limits to the effectiveness of behavior-based strategies (e.g., consumption levels can only be reduced so much without falling into starvation and labor supply increases are similarly capped), these differences have important short- and medium-term implications, particularly among households with low pre-shock consumption and market access. As a result, these households were forced into situations that lead them deeper into poverty. For example, 33 percent lowered their food intake, 10 percent put a child to work, and 8 percent pulled a child out of school in response to the shock. These percentages were higher for more costly shocks and among ultra-poor households. The short-term effectiveness of coping strategies depends on the type of shock, but appears limited. Approximately 43 percent of those reporting a shock declared that they had not recovered from it at the time of the survey, compared to 20 percent who declared to have fully recovered. The share of those who had not yet recovered increases with the estimated cost of the shock, and is significantly higher for health shocks.

14. **The ineffectiveness of informal risk coping mechanisms for these households suggests that social protection programs should focus on both poverty and risk management.** An effective social protection system would have to: (i) provide (minimum) income and other support for those with a small probability of exiting poverty, the chronic poor; (ii) implement mechanisms to exit poverty through access to economic opportunities and human capital; (iii) be risk responsive—high exposure to risk and high vulnerability require the safety net system to react quickly to shocks; and (iv) support risk mitigation to help households smooth income. Thus, programs must be capable of deploying assistance at short notice and expand and contract their beneficiary base as needs change.

III. Fighting risk and vulnerability: Pakistan’s social protection system

15. **Pakistan has many social protection programs ranging from cash transfers to pensions** (Table 1). The country’s social assistance includes two main federal cash transfer programs (Zakat and Bait-ul-Mal) and small scattered programs that provide social welfare and care services to persons with disabilities, child laborers, and others. Micro finance programs aim to give the poor access to credit. Although Pakistan has earlier implemented public works/workfare programs, no large workfare program is currently in place. To address aggregate economic (price) shocks, Pakistan implements a wheat subsidy program (there are also high expenditures on subsidies for power, water, gas, and fertilizer, which fall outside the scope of this report). Although no permanent program is in place to help individuals cope with aggregate disasters, Pakistan has used a combination of cash transfers, housing and social care services programs to help those affected by the 2005 earthquake. Pakistan’s social security system offers pension (old age, survivor and disability) benefits to formal sector workers. Public sector workers are provided civil service pensions, while private sector workers have access to pensions from the Employees Old Age Benefits (EOBI), but also provincially based pension and non-pension programs such as the Workers Welfare Fund (WWF) and the Employees’ Social Security Institutions (ESSI).

Table 1: Spending and beneficiaries of main social protection programs (2003/04)

	Expenditures	Share of GDP ^D	Share of total SP budget	Source of funding	Number of beneficiaries
	(Rs. billion)	(%)	(%)		
SAFETY NETS					
Income support and basic services					
Zakat (guzara and other)	5.9	0.10	11.3	Private (Zakat levy)	1.6 mn ^A (guzara: 0.8 mn)
Bait-ul-Mal ^C	2.5	0.05	4.9	Federal budget	1.25 mn ^A
Social welfare services	0.5	0.009	1.0	Federal budget	N.A.
Exit Policies					
Human capital accumulation--Tawana	0.7	0.012	1.3	Federal budget	530,000 ^A
Coping with Aggregate Risks					
Wheat subsidy	8	0.14	15.4	Federal and provincial budgets	N.A.
TOTAL safety nets	17.6	0.31	33.9		
SOCIAL SECURITY					
Public sector					
Civil service pension schemes (excl. military pensions) ^E	28.0	0.50	53.8	Federal and provincial budgets	0.8 mn retirees / 1.96 mn active workers
Private sector					
Workers Welfare Fund (WWF)	2.6	0.046	5.0	Private sector employers	N.A.
Employees' Social Security Institutions (ESSI)	2.1	0.037	4.0	Private sector employers	850,000 ^B
TOTAL social security	34.4	0.61	66.1		
TOTAL	52.0	0.92	100.0		

Sources: Issues and Policies Consultants (2004); World Bank (2006a); and information from program managers.

N.A. Not available

^A Number of beneficiaries of recurrent cash and non-cash benefits. ^B Number of workers covered by insurance scheme. ^C Budget of Bait-ul-Mal has since been increased to Rs. 4.5 billion (0.08% of GDP) and the number of beneficiaries of FSP, its largest program, to 1.45 mn. ^D Based on revised estimate of GDP (at current market prices) for 2003/04 of Rs. 5,641 mn. ^E Including military pensions would raise spending to Rs. 60 billion (1.07% of GDP), and beneficiaries to 1.9 mn retirees and 2.9 mn active workers. Total SP spending including military would then be around 1.4% of GDP. (Spending on Zakat and Bait-ul-Mal constitutes 0.14 percent of GDP in 2004/05)

16. **These programs are fragmented and duplicative.** For example, the country has two cash transfer systems with different modes of financing and delivery, but with similar objectives. Both programs offer (sometimes overlapping) non-cash benefits. Similarly, overlapping social security programs exist at federal and provincial level, to provide insurance coverage. These programs also provide stipends and training and in some cases even run their own health and education facilities, duplicating other public systems.

17. **Aggregate social protection expenditures are low and declining, and biased toward social security.** The country spends around 1.4 percent of GDP on social protection (comprising safety net, pension, and other social security spending, lower than in neighboring countries (compared to 4.7 percent in India and 3.1 percent in Sri Lanka).⁵ Some 80 percent of Pakistan's social protection expenditures are devoted to pensions and social security, which often benefit the non-poor and those in formal jobs, while only 20 percent of social protection spending and 0.3 percent of GDP is spent on safety nets, much lower than other countries in the region.⁶ Safety net spending on the two main safety net programs (Zakat and Bait-ul-Mal) has declined sharply, from 0.4 percent of GDP in 1991/92 to less than half of this level, or 0.14 percent of GDP in 2004/05. Further, safety net expenditures have also decreased as a share of total PRSP expenditures in recent years. For example, among the budget lines listed as PRSP, or pro-poor, expenditures, those that pertain to social protection (food subsidies, Bait-ul-Mal, Tawana school meals, social security, and low cost housing) fell from 7.2 to 3.3 percent of total PRSP spending between 2002/02 and 2005/06, as spending on other social sector programs increased.

A. Safety net programs

18. **The safety net system has the objective of helping the poor cope with poverty and risks.** The main programs in Pakistan are cash transfers, programs to help the poor exit poverty in the short or long term (conditional cash transfer pilots, microfinance and public works), social welfare and care services, and programs to help individuals cope with aggregate shocks (wheat subsidy and the recent earthquake relief effort). These programs face particular issues in reaching the poor and vulnerable:

Cash transfers

19. **Pakistan offers income support through two cash transfer programs, Zakat and Bait-ul-Mal.** Although both programs have similar aims and target populations, these programs have different histories, operations, and funding. Zakat is based entirely on contributions (currently voluntary but earlier mandatory) from wealthy individuals and uses community structures to deliver benefits. In contrast Bait-ul-Mal (PBM), introduced in the early 1990s, is funded and administered by the government. The primary objective of both programs is to provide cash transfers, but, as noted above, these programs also offer other (often duplicate) benefits such as stipends and training.

20. **As resources are limited and spread thin across overlapping programs, coverage is low.** Contributions to Zakat have declined significantly, from 0.3 percent of GDP in the 1980s to 0.08 percent in 2002/03, as more people opted out by either withdrawing funds before the day that Zakat is levied or by filing a declaration of exemption, leading to concomitant declines in expenditures on Zakat programs. Assuming these trends prevail in the future, Zakat is set to become a very small program in a few years once reserves are exhausted. Fiscal allocations for Bait-ul-Mal have increased, but not enough to compensate for the decline in Zakat. The two programs together cover two million households or 8 percent of the population with cash transfers; in contrast, some 8 million households are vulnerable to chronic poverty. Coverage levels are low when compared to other countries—Oportunidades in Mexico pays out transfers to 20 percent of the population (generally the poor), India's PDS system covers 37 percent of the population, while Sri Lanka's Samurdhi reaches 40 percent of the population (often not the poorest).⁷

⁵ It should be noted that the level of spending is not necessarily an indicator of the success of safety net programs. In both countries, program expenditures suffer from exclusion errors (many poor not covered) and inclusion errors (many non-poor covered).

⁶ This excluded hidden implicit fiscal liabilities of the pension fund (estimated at 25 percent of GDP).

⁷ These results are derived from PSNS (I), a nationally representative survey.

21. **Benefit levels are small and with infrequent and irregular payments.** For instance, the amount received by the average Zakat guzara cash transfer beneficiary during the 12 months before the survey was equivalent to 5-6 monthly installments, rather than the stipulated 12, and payments occurred with 6-8 months interval. Similarly, Bait-ul-Mal's Food Support Program benefits are paid on a bi-annual basis and there is a standing proposal to cut this further to one annual installment. Even though small benefit amounts may justify some clustering of payments to minimize transaction costs, clustering undermines the extent to which the program contributes to consumption smoothing.⁸

22. **Benefit delivery systems are weak with negative impact on program efficiency.** Major issues with Zakat and PBM's service concern the long response time for payment activation after program registration, the costs associated with cashing program benefits and the irregularity and lumpiness of benefit payments. While 20 percent of all applicants received their first payment within a month of application, 50 percent had to wait 1-6 months and 8 percent had waited more than a year. One in ten households had difficulty getting their funds. Beneficiaries on average made 1.6 visits to the payment center to obtain funds; one in twenty had to go three times or more. Moreover, one in ten beneficiaries declared to have paid a bribe to get their benefit at some point, with bribes averaging 10 percent of the transfer. Finally, beneficiaries complain about small, lumpy, and infrequent installments. Even so, all said and done, program beneficiaries found the transfers useful in providing some poverty relief.

23. **Although both Zakat and Bait-ul-Mal display elements of pro-poor targeting, they could still perform better.** The current fiscal allocation to cash transfer programs could be more efficient in covering the poor if program expenditures were better targeted. A sizeable share of benefits reaches the non-poor (inclusion errors), while many of the rejected applicants are poor (inclusion errors). Nearly 46 percent of total benefit expenditures of Bait-ul-Mal reach the poorest 40 percent of the population, while 43 percent of total Zakat expenditures reach the same population group.⁹ This performance could be improved. For example, 80 percent of expenditures on conditional cash transfers reach the bottom 40 percent of the population in Honduras; 62 percent of total expenditures reach this group in Mexico; and almost 50 percent of Food for Education resources go to the bottom 40 percent in Bangladesh.

24. **Weak governance and lack of transparent eligibility conditions reduce targeting effectiveness.** The main reasons behind poor targeting include (i) the lack of an objective targeting instrument: Both Zakat and Bait-ul-Mal target the 'deserving needy' and poor, but no objective targeting tool is used; (ii) the lack of an operational definition of poverty or targeting mechanism, that (iii) leave eligibility decisions in the hands of the chairmen and members of the local Zakat committees or of local authorities in the case of Bait-ul-Mal; and (iv) systematic differences in program access and eligibility which favor the non-poor—programs tend to be located in better off localities and benefits to increase with household income.

25. **Not surprisingly, these programs have little impact on poverty of recipient households.** Zakat guzara transfers and rehabilitation grants represent 14 and 23 percent of average recipient household income, respectively. Similarly, PBM's Food Support benefits are equivalent to 11 percent of household income among the ultra-poor, and to 8 and 5 percent among the poor and the non-poor respectively. In comparison, conditional cash transfer programs in Mexico and Nicaragua provide 21 percent of average household consumption. Given the small size of program benefits and non-poor targeting in Pakistan, poverty and inequality decline only slightly in response to transfers.

⁸ Results in paragraphs 21-22, 24-25 are derived from PSNS II, a survey of safety net recipients/applicants.

⁹ This result is derived from PSNS I, a nationally representative survey.

Programs for exiting poverty

26. **Pakistan is implementing several pilot safety net programs that aim to improve human development outcomes for poor children, thereby eliminating the inter-generational link to poverty.** Globally, there is a trend for cash transfer programs to include incentives to help poor children acquire human capital and avoid inter-generational poverty. These conditional cash transfers have successfully increased enrollment, improved health outcomes and reduced child labor¹⁰. Pakistan is also experimenting with these programs: (i) provincial stipend programs, including the Punjab Secondary School Stipend Program targeted to girls; (ii) Bait-ul-Mal's Child Support Program, a pilot conditional cash transfer program targeted to the poorest households; (iii) a school meals program (Tawana) that aims to improve nutrition and education of poor girls in rural areas; and (iv) a cash transfer program that targets improvement of health status (TB) alone. These programs all have program evaluations in place that will allow the government to gauge how programs impact educational and health outcomes of target groups.

27. **For the working poor, microfinance programs provide opportunities to the poor to exit poverty, but program coverage in Pakistan is amongst the lowest in the region.** Microfinance is offered through the banking sector (Khushali Bank) and NGOs (such as Rural Support Programs — RSPs). Pakistan has the lowest penetration of microfinance in South Asia with less than 2 percent of poor households covered. In Bangladesh and Sri Lanka, over 60 percent of the poor are microfinance clients and this share is 9 and 14 percent in India and Nepal, respectively. However, the impact of microfinance on those who receive them is positive. The slow growth of microfinance in Pakistan is caused in part by the lack of a solid and profitable core business, relying on subsidized donor funds rather than profitability (Rasmussen, 2005).

28. **In the past, Pakistan has implemented workfare programs to build infrastructure and offer temporary employment to the poor, but no major program currently exists.** Past programs include workfare for Afghan refugees and the Khushal Pakistan Program, though their overall impact on poverty reduction is not known. Currently, no public works program exists to target the poor through low wages or conditions on public works contracts to employ local labor.

Social welfare and care services

29. **Social welfare and care services are fragmented with low budgets, and their effectiveness is not well known.** The poor need only cash transfers, but also need services to improve their welfare, e.g., rehabilitation services for the disabled. The Ministry of Social Welfare and Special Education has been active in designing and providing several types of social welfare and care services programs for vulnerable groups such as working children, vulnerable women, and the disabled. The programs are publicly financed and administered by the federal government in some instances (e.g., special education schools for children with disabilities; PBM child labor or vocational training centers); provincial governments (beggar and drug addict homes; Punjab Child Protection Bureau); and districts (district social welfare offices). The delivery of services faces several issues: (i) Programs are fragmented and no over-arching framework for service provision to vulnerable groups exists. (ii) Public financing of social welfare and care services is low compared to needs (3 percent of social assistance spending), resulting in deficient coverage. Low budgets coupled with program fragmentation lead to poor coverage and weak administrative capacity to deliver and monitor services. (iii) The public sector remains focused on service delivery instead of policy development, setting service standards, regulation, and supervision. Finally, (iv) private provision of services by NGOs to vulnerable groups exists, but also with small coverage. The

¹⁰ See Chapter 3. Evidence on health outcomes is mainly from the evaluation of Mexico's *Progressa/Oportunidades* program.

Ministry of Social Welfare and Special Education is aware of these issues and has announced its intention to strengthen service provision to special vulnerable groups.

Programs for coping with aggregate shocks

30. **The government regularly intervenes in the wheat market through a subsidy with the understanding that wheat is a major staple** for Pakistani households, and therefore changes in wheat prices directly impact welfare, particularly of poor consumers and producers, but at significant economic and fiscal costs. Since resale prices are not high enough to cover payments to producers and storage and handling costs, the government incurs significant fiscal expenses. Over the last 10 years, annual wheat subsidy costs have averaged around Rs. 6 billion, with the subsidy fluctuating from 0.1 to 0.5 percent of GDP. About a third of the subsidy accrues to millers to cover the difference between the guaranteed purchase and resale prices, and the other two-thirds finance inefficient government grain procurement and handling procedures. Aside from creating distortions in wheat prices, and although more in-depth analysis is needed, preliminary evidence seems to suggest that the current system favors millers and the non-poor (Dorosh, 2004). The ability of the program to help the poor cope with wheat price shocks is therefore small.

31. **The recent earthquake exposed the gap in the ability of the government to cope with natural disasters.** Since no safety net structure existed that could be rolled out quickly, interventions had to be designed from scratch. The final relief package combined short-term income support (cash support) with long-term aid for reconstruction (housing). Community-based rehabilitation services anchored in four resource and information centers for persons with disabilities in the earthquake-affected areas are planned to complement this program. Following the earthquake, the government has developed the National Strategy and Plan of Action for Vulnerable Populations in Earthquake Affected Areas and the Earthquake Reconstruction and the Earthquake Rehabilitation Agency has approved its draft social protection strategy.

B. Social security programs

32. Safety nets address chronic poverty ex post, once it occurs. **Social security programs—insurance and long-term savings—in contrast, offer ex-ante protection and prevent households from falling into poverty.**

33. **Pakistan implements several pension schemes providing pensions—benefits against old age, disability, and survivorship—but also social benefits and services.** Civil service pensions for the public sector are the most important social security scheme, but benefits a small group of non-poor workers, and does not help the general population manage risk. Outside the public sector, salaried workers in the formal sector have access to health and maternity social security benefits, Workers' Welfare Fund (WWF) and Provincial Social Security (ESSI). Some of these programs provide other non-insurance benefits and services such as housing, dowry payments, and health and education facilities.

34. **Social security programs have low coverage and are focused on the non-poor because of the strong link between coverage and access to formal employment.** Coverage is limited to workers in the formal sector (30 percent of the non-agricultural labor force in 2003/04). Coverage is highest for the civil service schemes, while private sector programs reach a very small share of the labor force. Altogether, approximately 8.4 percent of the labor force has pension coverage. Low coverage rates are typical in low income countries given their small formal sectors.

35. **Schemes provide some, but largely inadequate, income support in case of disability, survivorship or old age.** Although all benefits are low, civil servants pensions provide higher benefits

than the main private sector pension scheme (the Employees Old Age Benefits—EOBI). EOBI benefits are 45 percent lower because of the lack of indexation. For other funds, it is not well known whether they meet their mandates and provide significant benefits to workers. The role of the government provident fund in providing retirement benefits is also limited by withdrawals for various purposes before retirement.

36. **The main public and private schemes are fiscally unsustainable.** Civil service pensions are financed from general revenues, with no contributions or fund accumulated to offset the liability. The size of this unfunded liability (or ‘pension debt’) is large when compared to published public debt figures and has been estimated (based on partial data) to be around 25 percent of GDP. Provincial government pensions will become a heavier burden in the next two decades as the civil service demographics play out. For EOBI, actuarial reports find that long-term benefits are not sustainable under current contribution rates, with cash flows becoming negative in less than two decades. To our knowledge, no actuarial calculations are available for the provincial programs such as ESSI.

37. **Professional asset management, modern accounting standards, and an investment policy necessary for sound management of social security reserves and financial sustainability of programs are not in place.** For example, during the last two decades, the EOBI has relied on investment through the National Savings Scheme, but from 2001 onward this investment was disallowed. With over 100 billion rupees in assets in 2005 and most of the portfolio maturing in 2006, the situation has become critical. Little information is available on the management of other funds; independent oversight is lacking. Investment policy statements are lacking.

38. **Administration and recordkeeping affect system coverage and performance.** Poor service—delays, lost records, and outright corruption—lead potential members and employers to avoid contributing to these schemes when possible. Conversely, weak monitoring and supervision allows greater evasion to take place. There are considerable gaps in information on workers covered by the scheme. This is because the institution is struggling to maintain and consolidate several legacy databases. Moreover, many employers, while making required payments, fail to submit individual payroll reports. With only a small part of the labor force covered by the scheme, operational cost of the EOBI run at least 20 percent of the collected contributions and almost one third of benefit payments. Though it is difficult to determine when administrative costs are excessive in public pension schemes, the current ratios clearly limit the long term sustainability of the scheme.

IV. An agenda for better social protection

39. **Consistent with its Poverty Reduction Strategy, the Government of Pakistan is aware of the poverty and vulnerability challenges confronting the country and is developing a more comprehensive approach to social protection.** This social protection strategy is an opportunity to establish priorities and goals for the social protection system as a whole and for specific programs to better articulate them around common guiding principles. Considering social protection as a system rather than a collection of different programs would allow the government to curtail fragmentation, improve the quality of social protection spending, and have higher impact. A strategy would be an opportunity to clarify the role and responsibilities of various social protection institutions.

40. **In moving forward, a social protection system can be organized around two pillars:**

- ***Productive safety nets*** to help individuals cope and escape poverty, with the flexibility to respond to natural disasters. This involves (a) reforming and strengthening basic income cash support, and linking it, based on pilot results, to improving human capital outcomes of the poor; and (b) gearing the system to respond more effectively to natural disasters and other aggregate shocks (e.g., droughts,

earthquakes). Piloting and evaluating innovative and affordable models to complement this basic safety net (e.g., workfare, and social welfare and care services) could be considered to strengthen basic income support, with scaling up pending fiscal resources and administrative capacity.

- ***Effective social security to reduce the individual's risk of falling into poverty.*** This much longer term effort could focus on (a) strengthening the formal social security system (public and private) through contributory schemes that offer consumption smoothing against individual risks (health, sickness, disability); and (b) given potentially high exposure to individual risks, piloting and evaluating innovative approaches to extend insurance coverage to the informal sector (e.g., social pensions or community based insurance), with scaling up based on administrative resources and fiscal capacity.

41. **Gradual, as opposed to simultaneous implementation of various reforms is desirable, given fiscal and administrative constraints.** As expansion of social security to address individual risks will take time to unfold, a well-targeted and administered safety net is likely to be the main social protection instrument for Pakistan in the near term.

42. **Given fiscal constraints, the expansion of coverage could be financed through better targeting of existing programs, phasing out untargeted programs and program consolidation.** Initial estimates show that a package of reforms, such as the one noted below, could significantly increase total annual expenditures on safety nets,¹¹ which may not be fiscally or administrative feasible in the near future. Thus, as a first measure increasing coverage will mean better targeting current programs, and reducing fragmentation and duplication of efforts across agencies (e.g., various stipends programs) and reducing untargeted programs (e.g., wheat subsidies). Increase in coverage over and beyond these resources will need to be phased in as resources and administrative capacity allow. However, the declining share of GDP spent on safety net programs is worrisome and it is therefore welcome that the government is considering how best to ensure adequate yet fiscally affordable spending on safety nets in its draft social protection strategy. Over time, the share of resources to social security programs, largely availed by the non-poor, will also need to be redressed and better linked to individual contributions and any expansion of coverage (including social pensions) in social security will need to be carefully considered against available resources. To pool resources across rich and poor provinces, safety net programs need to be federally financed. Social security pool risk through individual contributions that are calculated on actuarial fairness, safety nets are general revenue financed in order to pool risks across rich and poor regions.

43. **Improvements in administrative arrangements are needed for better delivery of social protection benefits and services.** Without adequate administration, public information, and incentives to promote better governance, even the best designed programs can fail. Better governance of safety nets includes streamlining of benefits, clarifying roles of public actors, facilitating private sector partnerships, strengthening data collection and reporting systems, refining targeting systems, increasing system outreach, strengthening staff and management capacity, and setting up monitoring and evaluation. Better governance of social security would involve strengthening the capacity to forecast and simulate the impact of reforms, modernizing record keeping, and improving management and oversight of funds. Public information will be important for higher program outreach and public relations campaigns could be used to communicate and seek support for reforms.

44. **Social protection reforms will need leadership and inter-institutional coordination.** While several separate agencies run different programs, policy needs to be coordinated to ensure national policy goals are met, synergies reached, and fragmentation avoided. Other countries with a similar challenge have retained their Ministry of Social Welfare or its equivalent in a coordinating role for social assistance

¹¹ Appendix 4 provides potential costs under particular assumptions of coverage and benefit levels.

and the Ministry of Labor or its equivalent in a similar role for social security. In Pakistan’s case, the Ministry of Social Welfare and Special Education would seem a natural choice for overseeing and coordinating safety net reforms, since the minister chairs the Cabinet’s social sector committee, but it would need strengthened capacity to design and evaluate policy. Coordination is important. For example, developing and implementing conditional cash transfers calls for coordination between Ministry of Social Welfare, Bait-ul-Mal, Health, and Education. Similarly, social security and employment-based programs could be overseen by the Ministry of Labor after consolidating some of the current implementation arrangements that split responsibilities between federal and provincial agencies.

Table 2: Overview of main programs, target groups, and expected outcomes

Program	Target group	Expected program objective after reform	Priority being addressed
1. Safety Net			
a. Basic Income Support and Services			
<i>Unconditional</i>	<i>Chronic poor</i>	<ul style="list-style-type: none"> • <i>Income support</i> 	<ul style="list-style-type: none"> • <i>Protecting against poverty including from aggregate shocks</i>
Social care services (pilot)	Vulnerable groups (disabled, children, others)	<ul style="list-style-type: none"> • Enhanced welfare of target groups 	<ul style="list-style-type: none"> • Protecting against poverty including from aggregate shocks
b. Promoting Exit			
<i>Transforming unconditional to conditional Transfers</i>	<i>Chronic poor (with children)</i>	<ul style="list-style-type: none"> • <i>Increase Human capital of poor children/mothers</i> 	<ul style="list-style-type: none"> • <i>Promoting exit from poverty</i>
Links to micro finance, skill development	Chronic poor (adults)	<ul style="list-style-type: none"> • Increased access to economic opportunities 	<ul style="list-style-type: none"> • Promoting exit from poverty
c. Addressing Aggregate Shocks			
Workfare (pilot)	Poor or vulnerable households with members of working age	<ul style="list-style-type: none"> • Income support • Lower income volatility 	<ul style="list-style-type: none"> • Promoting risk management
2. Social Security			
a. Formal Social security	Formal sector workers (platform for informal workers)	<ul style="list-style-type: none"> • Protection against old-age poverty, disability and survivorship 	<ul style="list-style-type: none"> • Promoting risk management
b. Informal Security (pilot of community based insurance; social pensions)	Informal Sector	<ul style="list-style-type: none"> • Protection against health shocks 	<ul style="list-style-type: none"> • Promoting risk management

45. We now turn to key areas of action for each of the two parts of the system.

A. Developing productive safety nets

46. A more effective safety net will require a strengthening of the basic cash transfer and social welfare system that incorporates incentives for exit from poverty and is able to respond to natural disasters.

Cash transfers

47. **Expansion of coverage.** The coverage provided by Zakat and Bait-ul-Mal cash transfer programs needs to be expanded if programs are to act as significant poverty alleviation mechanisms. Coverage can be expanded through efficiency gains, for example, through improvements in administrative efficiency (e.g., better targeting and consolidation of benefits) under current levels of expenditures. Further expansion of coverage will need to be considered in line with administrative capacity and the availability of fiscal resources.

48. **Level of benefit: balancing adequacy, coverage, and incentives.** Cash transfer programs currently pay low benefits. However, any increase in benefit needs to balance adequacy—or assistance needed to meet basic needs—with work incentives. Although some increase in the very low level of benefit would not compromise incentives, raising benefits for all recipients would need to be weighed against expanding program coverage, which seems a more immediate need. Moreover, large one-off and poorly targeted benefits could be phased out in favor of small well-targeted regular transfers. Benefit payment should be regular (every few months) and timely to allow households to smooth consumption. The duration of benefit also needs to be reconsidered by defining a program graduation policy—limiting benefit duration or periodical re-checking of eligibility.

49. **Improving targeting efficiency: adoption of an objective targeting instrument.** A number of targeting instruments can be considered for Pakistan, including proxy means testing. This method uses a weighted average of observable characteristics to determine eligibility. Given its reliance on easily verifiable characteristics rather than formal income, it is usually suited to countries with informal economies. Another important advantage of proxy means test would be to base beneficiary selection on quantitative and objective criteria. However, this instrument will need to be piloted and evaluated and may well need to be combined by other methods, such as geographic and community based targeting, for improving the accuracy of targeting the poor.

50. **Reducing program fragmentation could enhance effectiveness.** Although Zakat and Bait-ul-Mal share a similar objective of providing basic support to the poorest households, they have different histories, target groups and financing methodologies and their coordination will need to be improved. But there are many smaller programs within these two cash transfer systems that are duplicative (e.g., stipends/training, and one-off grants) and will need to be consolidated or phased out. Moreover, as positive as it is to see numerous conditional cash and in-kind transfer initiatives flourishing in various areas of the country, it is important that experimentation leads to overall consolidation rather than fragmentation of cash support programs. Assessments of ongoing initiatives must pay attention to the extent to which these can be successfully scaled up and integrated within a unified cash transfer system to improve living standards among the target groups. Further, it will also be important to ensure that natural disaster assistance and relief is part of the main social protection system, so that there is in-built capacity for system to expand in a coordinated fashion to address future shocks.

51. **Incorporating incentives to poverty: conditional cash transfers.** Cash transfer programs could be combined with graduation mechanisms to enhance their effectiveness. For long term exit from poverty, conditional cash transfers are a potential instrument to help improve the health and education outcomes of poor children. The Child Support pilot could be scaled up, if evaluation results show it to be effective, to promote education among poor beneficiaries of the cash transfer program. The potential inclusion of incentives for improving health and nutrition outcomes, in addition to education outcomes of the poor, could also be piloted and evaluated. It is important to note that these interventions require attention to supply of services and need to be coordinated closely with health and education programs. Conditional

cash transfers can also reduce child labor—as is the case in Bangladesh, for example¹²—though their impact could potentially be augmented through community awareness and ‘bridge schools’ that help transit working children into the regular school system. For promoting graduation of the working poor, cash transfer programs could gradually adopt mechanisms that would help facilitate access to microfinance, skills development, or public works to improve income earning capacity.

Social Welfare and Care Services

52. **Innovative models of social welfare and care services that complement cash transfer programs could be piloted and evaluated to ascertain their feasibility for expansion, pending availability of fiscal resources.** The poor and vulnerable require not only cash transfers but also services, e.g. rehabilitation for disabled. These services are in their nascent phase in Pakistan and need to develop innovative and fiscally viable options, potentially focusing on a community based approach, to deliver services to the poor. The public sector will need to shift its focus to policy development, regulation and monitoring and evaluation, and options for outsourcing the provision of care to private sector or community organizations will need to be considered.

Coping with aggregate shocks

53. **To address natural disasters, a combination of cash transfer and, as these develop, social welfare and care services could be used, but their flexibility for addressing frequent shocks is limited.** Cash transfer and services programs are by their nature targeted, so that their elasticity of response, particularly for more frequent shocks, is often low. The wheat subsidy, given its limited impact on the poor, could be phased out, and the poor protected with a stronger targeted safety net.

54. **Workfare could be piloted and evaluated to explore its role in addressing unemployment from aggregate shocks, such as droughts.** A workfare (or cash for work) program that can expand in time of natural disasters, e.g., droughts and contract in other time periods could help protect households from loss of income in times of this and other natural calamities. Pakistan has experience with three labor intensive workfare projects targeted to the Afghan refugee population in Pakistan during 1984-1996. While their overall impact on poverty is not known, the projects created 22.6 million person days of employment over a 12-year period and transferred vocational skills to participants. It should be noted that workfare programs can be administrative complex to develop, and should be piloted and evaluated, with expansion contingent on the availability of fiscal resources. International evidence suggests the design of the program should, inter alia, establish wage rates set low enough to encourage self-targeting by the very poor.

B. Social security: helping individuals mitigate risks and avoid falling into poverty

55. **Despite its longer term implementation, Pakistan could still develop a vision for its future social security system.** This longer term view would better enable the country to guide reform efforts in a coordinated and comprehensive fashion. A longer term vision—with clear benefit targets for old age, disability, survivors insurance, and health coverage—is the first steps toward a coherent social security system. Financing sources consistent with estimated costs based on actuarial calculations would be needed. Fundamental reform calls for identification of risks to be covered, target replacement rates to be defined, and determination of financing parameters and administrative and implementation arrangements. An explicit decision would then be needed on the share of costs to be pre-funded or passed onto future taxpayers. Institutional and administrative arrangements for cost and risk pooling would also be decided. However, transition from the current situation to the new long term vision may take a generation to

¹² See Ravallion and Wodon (1999).

unfold. In the meantime, strengthening the formal social security system and considering innovative approaches to extend coverage to the informal system might be considered.

Strengthening formal social security systems

56. **Improving fiscal sustainability and financial management.** The fiscal sustainability of civil service schemes can be improved through parametric changes in the system—changes in the assessment base, accrual rates and retirement age. This will lower short term and the present value of future pension spending. Systemic changes in the system—shifting to defined contribution system—would take up front fiscal outlays, but would eventually lead to a much more sustainable civil service pension system, lowering the present value of fiscal expenditures on pensions, from 71 to 47 percent of GDP. Options for improving the fiscal sustainability of EOBI will also need to be considered, including improvements in the financial management of reserves. Information on the management of other funds also needs to be improved, including strengthening independent oversight. Investment policy statements and processes will need to be defined and disclosure improved.

57. **Improving administrative capacity (recordkeeping and oversight).** Monitoring systems will need to be strengthened to avoid evasion, thus improving the financial position of funded schemes. Improvements in tracking of individual earnings for the pension department to make accurate payments will be needed for parametric reforms in the civil service scheme. For a defined contribution (DC) scheme, record keeping would have to be much more stringent. Improving enforcement mechanisms for late payments and reporting is needed. In all schemes, monitoring is weak and will need to be considerably strengthened.

58. **Reducing program fragmentation.** Administrative costs may be reduced through the consolidation of certain activities in one institution (e.g., cash transfers), as has often been proposed. Steps toward this include harmonization of practices (reporting, accounting, audits, actuarial evaluations) and establishing a common, updated database. Simplifying the process for registration and collection for employers would also help compliance. In this regard, the current effort to consolidate legislation is a welcome first step, though processes for external oversight are needed.

Extending coverage to the informal sector

59. **Microfinance and community based groups are emerging as one way of expanding coverage to the informal sector.** Their penetration is still low, and using these institutions to expand coverage would have a long gestation period. However, there might be scope for using community-based groups for providing insurance products in Pakistan as already happening with the rural support programs. These groups could ‘plug into’ a formal sector arrangement, for example a defined contribution pension cum insurance. Combined with civil service pension reforms, this could create a seamless system of pension coverage and other group insurance. It would allow easier movement between informal and formal, public and private sector work and lower administrative costs that would tend to be duplicated under parallel schemes. However, these schemes would have to be piloted and evaluated, and their fiscal costs assessed prior to any expansion.

60. **Social pensions are another way to extend coverage to elderly without access to a formal pension, but their costs and consistency with other safety net programs needs to be carefully considered.** In many countries around the world and in the South Asia region, cash transfers to the elderly (or social pensions) are used to provide informal sector workers with income support in old age. These pensions can be means tested (India) or provided to all individuals over a particular age (Nepal). Social pensions can be costly, with costs increasing with the aging of the population. Further, the advantages of providing separate benefits to the elderly need to be assessed against the poverty needs of

other groups. The feasibility of using the existing cash transfer system to target the elderly also needs to be assessed prior to introducing social pensions. In Pakistan, the North-West Frontier Province (NWFP) is experimenting with social pensions in select districts, with expansion contingent on evaluation of pilot results and fiscal resources.

CHAPTER 1. INTRODUCTION

1.1 What is the rationale for this report and what is its expected value added in Pakistan's current context? More generally, what is the role of social protection and why is it important? This first chapter provides the reader with some background information about the genesis of and motivation for this report, as well as with a rough overview of the report's structure and contents. The chapter also proposes a general framework for the discussion of the role of social protection in fighting poverty and vulnerability, which is then applied to Pakistan's context in the report.

I. WHY THIS REPORT AND WHY NOW?

1.2 **After stabilizing the economy, Pakistan has seen strong economic growth in recent years.** Economic growth has accelerated to 4.8 percent in 2002/03, 6.4 percent in 2003/04, 8.4 percent in 2004/05, and 6.6 percent in 2005/06. Broad development outcomes, including social indicators, are also improving throughout the country. The resurgence of the economy provides the opportunity and the fiscal space to invest more in poverty alleviation and in the social sectors, and the government has repeatedly emphasized its desire and intent to address poverty in a more comprehensive manner.

1.3 **Yet important vulnerabilities remain, as evidenced by the recent earthquake and its aftermath.** While economic growth is the key force behind poverty reduction, international evidence suggests that not all groups benefit from growth, and despite growth, poor and non-poor alike (in all, including higher income countries) remain vulnerable to individual level risks, such as health, disability and unemployment, but also to community wide shocks, such as natural disasters. The tragic earthquake which struck the northern parts of Pakistan on October 8, 2005, and a series of droughts in previous years has demonstrated extreme vulnerability of the population to natural disasters and placed vulnerability center-stage as a major policy concern.

1.4 **Pakistan's poverty reduction strategy calls for particular attention to growth with equity.** Pakistan's social protection system comprises safety nets (a number of cash programs, subsidies, and employment promotion programs) and social security (pensions and health coverage) for the formal sector. The government's poverty reduction strategy (PRSP), finalized in late 2003, recognizes the vital role of social protection programs (safety nets and other targeted programs and social security) in reducing the vulnerability of households to poverty and to cushion them from the impacts of individual and community-wide shocks (Government of Pakistan, 2003). As the impact of these programs was not known, the PRSP called for an in-depth study of the social protection programs, with a focus on safety nets.

1.5 **At the request of the Government of Pakistan, this report evaluates the country's social protection system in light of existing challenges and makes recommendations for improvements.** Specifically, the study (i) presents a complete poverty and vulnerability profile to identify the main challenges to be addressed by social protection (Chapter 2); (ii) critically reviews existing policies and programs, paying special attention to their capacity to address these challenges (Chapter 3); and (iii)

proposes a comprehensive policy agenda with both sectoral and program-specific recommendations aimed at increasing the efficiency and effectiveness of Pakistan’s social protection system (Chapter 4).

1.6 The report is the result of an inter-institutional collaborative effort between several stakeholders: the Government of Pakistan, civil society, local and international researchers, and international donors. In June 2004, the government appointed an inter-agency Steering Committee on Social Protection led by the Chief Economist of the Planning Commission and co–chaired by the Executive Director of the Pakistan Center for Philanthropy. Representatives from international agencies, including the ADB, the UK Department for International Development (DFID), and the United Nations Development Program (UNDP) were also part of this working group. The workshops and seminars organized by the Committee have been important for advancing the dialogue among all stakeholders on the road ahead in terms of formulating a social protection reform strategy and action plan; a draft final strategy is now with the government for approval, and the initial findings and diagnostics of this report have been a key input to this. The committee has also supported the launch of a pilot conditional cash-transfer program and the inclusion of a social protection chapter in the country’s Medium-Term Development Framework.

1.7 The discussion draws on both existing knowledge and original work¹³ and uses administrative and survey data, including a new special-purpose safety net survey commissioned specifically for the report (see Box 1.1 for details on this survey). The Safety Net Survey was commissioned by the Steering Committee to assess households’ risk coping behavior, the role of informal transfers, and the effectiveness of formal safety net programs, under supervision of the Federal Bureau of Statistics. The survey was implemented by Gallup Pakistan, with financial assistance from DFID and technical support from the Federal Bureau of Statistics. Other data sources include information from program officials at federal, provincial and local level, Pakistan Integrated Household Surveys, and fieldwork observations. The report draws on three different phases of the safety net survey, which have very different sampling properties (Appendix 1 provides more detail on the survey).

II. WHAT IS SOCIAL PROTECTION?

1.8 The broad objective of social protection (SP) policies and programs is to guarantee a minimum and stable level of income for those most in need, while providing them with the necessary means to smooth income over time and eventually exit poverty. Basic income support and essential services ensures that the living conditions of the chronic poor and those who fall into poverty (as a result of a shock) do not deteriorate beyond a minimum acceptable level, while increasing access of the poor to employment opportunities and through investments in human capital among the poor to open new avenues for them to exit poverty. Similarly, putting mechanisms in place for risk mitigation helps (vulnerable) households maintain more stable consumption levels and potentially prevents them from falling into poverty.

¹³ Background papers were written by Issues and Policies Consultants (administrative review of programs); Carlo del Ninno, Giovanni Vecchi, and Noshin Hussain (on vulnerability); Paul Dorosh (wheat policy); Kalanidhi Subbarao (workfare); Deborah Schlichting (qualitative study of risk coping); and Nadia Maleeha Assad (literature survey). In addition, we also draw on a DFID-sponsored paper by Kabeer, Mumtaz, and Sayeed (transformative social protection) and on an ADB-sponsored background paper by Faisal Bari, Emma Hooper, Shahid Kardar, Shanza Khan, Irfan Mohammed, and Asad Sayeed (conceptualizing a social protection framework for Pakistan).

Box 1.1: An Overview of the new Pakistan Safety Net Survey

The Safety Net Survey (PSNS) was designed to assess households' risk coping, the role of informal transfers, and the effectiveness of formal safety net programs. The survey was implemented by Gallup Pakistan, with financial assistance from DFID. The report draws on three different phases of the safety net survey, which have very different sampling properties (Appendix 1 provides more detail on the survey).

Phase I was a survey of 30,005 households, randomly selected from 300 sample locations all over Pakistan, collected during June-July 2005. The instrument included questions related to schooling, disabilities, health services, public and private assistance, pensions, income and expenditure, household assets and basic demographic characteristics of households. Phase I did not include an expenditure module, and we constructed quintiles defined on the basis of brief, self-reported expenditures. A village survey of key informants was also undertaken. Phase I was designed to be representative at the national and provincial level.

Phase II was an in-depth survey of 2551 households selected among safety net beneficiaries and comparison groups such as applicants and those who felt the need for assistance but didn't apply, from the same 300 locations. Information was collected on sources of vulnerability, coping strategies, private transfers, participation in formal safety net programs, and consumption expenditures using a consumption module identical to the one used in the Pakistan Integrated Household Survey. The Phase II survey was designed to result in a sufficiently large sample of safety net beneficiaries and applicants—these groups were therefore over-sampled, and as a consequence nationally representative poverty estimates cannot be derived from Phase II. Based on expenditures per capita and using the official poverty line updated to reflect current prices, we constructed three income groups: (i) the ultra-poor, defined as households with expenditures below the food poverty line (Rs. 457 per capita per month), (ii) the poor, meaning households with expenditures below the official poverty line (Rs. 816 per capita per month) but above the food poverty line, and (iii) the non-poor, households with expenditures above the poverty line. Thirty-eight percent of households in the Phase II sample are ultra-poor, 35 percent are poor (but not ultra-poor), and 27 percent are non-poor, reflecting a sample that is tilted toward the poor. This means that the averages of the whole sample would be largely representative of low-income poor and vulnerable households (see Appendix 1).

Phase III was a tracing (or tracking) study in which the names and addresses of 527 random beneficiaries were obtained from administrative records. The enumerators then attempted to locate these households to verify that they exist and are in receipt of benefits. Results are described in Appendix 1.

1.9 Social protection is not a substitute for economic growth, which along with human capital development of individuals will remain pivotal for poverty reduction in Pakistan. Social protection can complement policies for creating growth and building human capital, and also help individuals cope with (and where possible exit) poverty and manage risk. Public social protection instruments should strive to add to the choices and options available to households, and where feasible explore potential synergies with informal and market-based risk management instruments used by households. Thus, public risk coping instruments need to be designed, keeping in mind the larger landscape of risk management strategies employed by households, markets, and society at large.¹⁴

1.10 **Although households often use informal or private mechanisms to (partially) insure themselves against income fluctuations, there is a strong rationale for government provision of social protection.** First, governments may want to achieve an income distribution that differs from that generated by the market. They may, for instance, have a preference for a more equal distribution or a distribution that guarantees a minimum level of income for those at the very bottom with the understanding that lower poverty and inequality lead to higher economic growth (Perry et al, 2006). Second, governments may wish to correct market failures that leave households with insufficient insurance and risk pooling mechanisms (World Bank, 2005f). There are many benefits of addressing risk directly. Risk affects household welfare negatively through higher consumption variance, which can result in transient poverty. Uninsured risk also affects household welfare indirectly: in the absence of

¹⁴ Holzmann and Jorgenson (2000).

well-functioning insurance markets, households reduce risk by choosing activities and asset portfolios with low risks and low returns. Innovation and investment can be stifled (World Bank, 2005j). Thus, uninsured risk and shocks not only push households into poverty, but also perpetuate their impoverishment by reducing opportunities for escaping poverty (Dercon, 2002).

1.11 Social protection is generally provided through a mix of safety net (social assistance) and social security/insurance programs.¹⁵ Safety net/social assistance programs deliver transfers and or services to the chronic poor and those who fall into poverty as a result of a shock. In this sense, they allow individuals to *cope with poverty ex-post* (after a shock has occurred). Cash transfer programs, feeding programs, employment programs, e.g., workfare, or social welfare and care services (care of disabled and elderly) are examples of safety nets programs. Social security programs provide insurance against particular shocks or events by pooling risks across program participants. These programs allow individuals to *mitigate risk (ex ante)* and avoid falling into poverty. Safety net programs are financed by general revenues, while social security programs are financed by contributions paid by participants themselves or by the government/others on their behalf. Pensions, health insurance or unemployment insurance are examples of social security/insurance programs. Yet in practice the boundary between these two types of programs can break down. Some safety net programs, if not subject to a binding budget constraint, can be viewed as a risk-pooling mechanism across the entire general population, with contributions being paid via taxes and benefits being drawn according to need. Seen in this way, some safety net programs such as workfare perform an unemployment insurance function for informal sector workers. On the other hand, social security/insurance programs may be partially funded from general tax revenues, as mentioned above, hence resembling a subsidy (World Bank, 2004).

1.12 To ensure maximum effectiveness, however, this mix needs to be a function of the country's context and needs in terms of poverty and vulnerability. Poverty levels and exposure to risk varies across countries and across regions and areas within countries. Similarly the poor and the vulnerable are heterogeneous groups, with different capacities and needs. While some households are likely to be poor and to remain poor in the future, others could escape or remain out of poverty if provided with the right endowments and support. Countries with high or stubborn poverty levels or with deep pockets of poverty may want to focus on income support or basic service programs that are well targeted, while those where exposure to risk is high may be better off putting more emphasis on insurance or on programs that have the capacity to deploy assistance and to expand and contract fast in response to either individual or aggregate shocks.

1.13 Attention should also be paid to the role played by existing formal and informal mechanisms for poverty alleviation and risk mitigation and coping, so as to promote complementarities between public and private interventions. Some analysts are concerned that public assistance may crowd out private transfers or create disincentives to work.¹⁶ Although the empirical evidence on this is mixed, when policymakers design public systems they do need to take into account the potential displacement of private risk management mechanisms. For example, for social insurance, a key concern is to regulate the private insurance market where it exists, and to augment the market by providing risk pooling mechanisms where markets fail. Another concern is to avoid the disincentives to work entailed by some forms of social security, e.g., unemployment insurance and social assistance (e.g., generous cash benefits). For redistributive programs, a key concern is to avoid displacement of private cash or in-kind support, as when the extended family provides help and shelter to orphans, widows, and other poor. This being said, informal risk coping is sometimes inefficient, inequitable, or detrimental and in need of replacement. Thus, if private risk coping consists of usurious loans, child labor, patron-client

¹⁵ Social security programs also include employment protection legislation, but the discussion of this topic is outside the scope of this report.

¹⁶ Jimenez and Cox (1992).

relationships, or emergency asset sales, substituting it with well designed formal mechanisms is a policy objective, not a cause for concern. Appropriate design of social protection policies therefore has to take into account both the potential negative effect of displacing private transfers, and the potential positive effect of replacing inefficient, inequitable, or detrimental private risk coping with formal mechanisms (World Bank, 2005f). This can only be achieved if public interventions are considered against a general understanding of household risk management strategies.

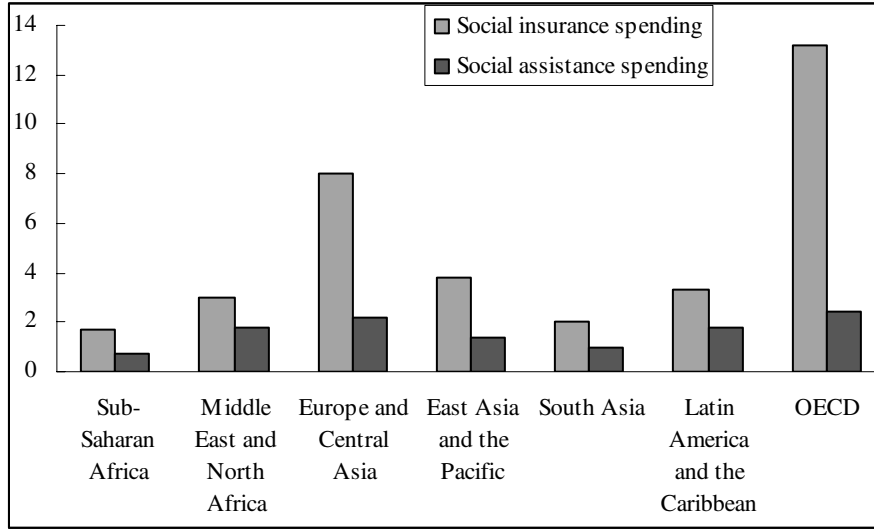
1.14 Social protection systems have to be adequately financed but also fiscally sustainable. Low and unstable levels of resources or resources that are spread too thin across too many initiatives will significantly compromise the effectiveness of the social protection system, especially if social protection programs are pursuing long-term goals such as human capital accumulation or promotion of viable economic opportunities. However, generous programs that are fiscally unsustainable can also compromise growth (e.g., pay as you go pension programs that require high payroll taxes and budget transfers to support an aging population). In addition, poor targeting of a given amount of resources can reduce financial efficiency and also compromise equity. On average, social protection program expenditure varies by level of income of the country, with higher income countries about 3 percent of GDP on social assistance, and a much higher proportion on social security. Spending for both categories is much lower for lower income countries although, at least in the case of South Asia, the distribution of expenditures across these categories is similar to that found in higher income countries.

1.15 Programs need to take into account the economic environment and with strong implementation arrangements. The smaller formal sector and lower tax base of lower income countries as in the South Asia region implies that safety nets comprise the main social protection mechanisms for the poor. Social security programs which are linked to formal sector participation cover a very small proportion of the population. While some countries are attempting to expand social security coverage to the informal sector, financing and administrative arrangements are often not adequately fleshed out prior to program rollout, leading to a paralysis in implementation. That said, many innovations in social protection design have emerged precisely to adapt to low income environments. For example, as means testing of social assistance is difficult in countries where income is largely informal and often impossible to ascertain, many countries are using a ‘proxy means testing’ that relies more on categorical and more easily identifiable indicators for targeting benefits to the poor.

1.16 Finally, social protection programs need to be politically viable, but also can provide political support for economic and structural reforms. There is often a trade-off between targeting and political/social support for a particular program. Some analysts argue that if anti-poverty programs are very narrowly targeted, they may lose middle class and political support. Good examples of this trade-off could be found in two of the region’s largest (and most popular) programs, the Public Distribution System (subsidized food) in India and the *Samurdhi* program (food stamps and cash transfers) in Sri Lanka, both of which spend around 1 percent of GDP, and neither of which are well targeted. The same reasoning would explain why most countries, including Pakistan, spend more on social insurance, which tends to benefit the non-poor, than on safety net programs, which target the poor (Figure 1.1). For the same reason, social protection programs are difficult to reform. Groups that may lose out from reforms often strongly oppose them. Still, many countries, from Jamaica to Poland to Bangladesh, have enacted difficult reforms to improve the functioning of social protection systems. Many countries have also used social protection programs strategically to cushion the social impact of major reforms, e.g., spur restructuring of enterprises or reduction in price subsidies, thereby reducing political opposition to reforms and promoting dynamic efficiency.

1.17 With this framework in mind, we now turn to a discussion of the risk and vulnerability in Pakistan (next chapter) as a background for the discussion on social protection programs and policies that follows in the rest of the report.

Figure 1.1: Most countries spend more on social insurance than on social assistance (percent of GDP)



Source: World Bank (2005j) “World Development Report 2006” based on data on 74 countries taken from World Bank Public Expenditure Reviews or similar work. OECD data are from the OECD Social Expenditure database. The average for Africa is based on data for only two countries. OECD excludes those OECD members that are already accounted for in the regional averages.

CHAPTER 2. IDENTIFYING THE NEEDIEST AND MOST AT RISK: A PROFILE OF POVERTY AND VULNERABILITY

I. INTRODUCTION

2.1 Who are the poor and where are they located? How likely are poor households to exit poverty in the future? Are non-poor households prone to enter poverty? Are there significant differences between poor and non-poor households in terms of education and health outcomes? This chapter presents a basic poverty and vulnerability profile for Pakistan in order to answer these and other related questions. In doing so the chapter aims to provide the reader with an accurate picture of the main challenges facing the country in the area of social protection.

2.2 The discussion is structured around three complementary issues: poverty, risk and vulnerability, and risk coping mechanisms. Section II provides a detailed discussion on the incidence and impact of shocks for recipients and applicants of safety net programs. Building upon the results from this discussion, it argues that vulnerability to poverty may prove to be a more informative measure of welfare in environments with high levels of risk and uncertainty. The section concludes by developing an operational measure of vulnerability. Section III combines these ideas to construct poverty and vulnerability profile, including a short overview of basic education and health outcomes among poor and non-poor households. Against this background Section IV examines existing informal risk coping mechanisms, their impact and effectiveness. Section V concludes the chapter. The chapter draws on two data sets: (i) the nationally representative Pakistan Integrated Household Survey (PIHS), and (ii) the Pakistan Safety Net Survey (PSNS II), which is representative of safety net recipients/applicants.¹⁷ The latter provides information, inter alia, on incidence and costs of shocks experienced by these households and thus cannot be generalized to the population as a whole.

2.3 The chapter's main findings can be summarized as follows:

- Exposure to poverty and risk is high among Pakistani households. Some 24-29 percent (depending on choice of poverty line) of the Pakistani population was poor in 2004/05. Households are also subject to risks. The survey of safety net recipients/applicant households (PSNS II, 2005) finds that nearly two thirds of surveyed households—of which 80 percent are poor—suffered one or more severe shocks during the three years prior to the survey.
- The same survey (PSNS II) finds that the frequency, nature and impact of shocks vary with socio-economic characteristics and areas of residence of these households. While about the same number of poor and non-poor households in this group experienced shocks, conditional on suffering a shock, ultra-poor and poor households were more likely to suffer health shocks than non-poor households, while the latter were more likely to suffer economic shocks than the former. In addition, urban households are more prone to shocks than rural ones and, conditional on the occurrence of a shock,

¹⁷ Applicants are actual and potential (that is, those who noted that they were in need but did not apply for benefit).

they are more likely to suffer health and economic shocks and less likely to suffer shocks related to natural disasters. Finally, shock-related expenses represent 54 percent of annual consumption for ultra-poor households compared to 27 percent for poor households and 18 percent for non-poor households. And households in rural areas spend 37 percent of their annual consumption coping with shocks compared to 30 percent for urban households in this group.

- The notion of vulnerability, measured as the likelihood that households remain or become poor in the future, shows that approximately 56 percent of households are vulnerable (based on the nationally representative PIHS 2001/02). Half of this burden stems from vulnerability to chronic poverty (low levels of consumption), while the other half is associated with vulnerability to transient poverty (exposure to risk and variation in consumption levels).
- Poverty and vulnerability levels, based on the above survey (PIHS 2001/02), vary with area of residence and with household and individual characteristics. They are highest among rural households, particularly those employed in the informal sector, in the agricultural sector or those with no access to land or other productive assets. They are also positively correlated with low levels of human capital, which makes observed differences in education and health outcomes between poor and non-poor children particularly worrisome as they may contribute to perpetuate intergenerational poverty.
- The survey of safety net households mentioned above (PSNS II) finds that these households employ various strategies to deal with shocks. These strategies can be asset-based (e.g., use of existing savings) or behavior-based (e.g., increase in labor supply). The non-poor among this group are more likely to use the former while the poor are more likely to use the latter. Strategies also vary in terms of their (short-term) effectiveness and their medium-term impact.
- Evidence on low levels of effectiveness and potentially harmful medium-term welfare impacts of household risk coping strategies suggest that there is ample room for improving the effectiveness of public programs in the area of risk mitigation and risk coping.

II. POVERTY, RISK AND VULNERABILITY¹⁸

Poverty trends

2.4 **Recent economic growth has reduced poverty in Pakistan. Poverty fell from a high of 34.4 percent in 2001/02 to 29 percent (using a unit price deflator) and 24 percent (using the consumer price index as deflator) in 2004/05.** The incidence of poverty fell during the 1980s and the early 1990s, but had increased thereafter as a consequence of, among other factors, a series of severe droughts that affected the country in the late 1990s and early 2000s. This explains why rural poverty increased by about 4 percentage points between 1998/99 and 2002/02, and significantly more so in Sindh, while few changes occurred in urban areas leading to an increase in the rural-urban poverty gap.¹⁹ (See Figures 2.1 and 2.2).

¹⁸ This section draws from World Bank (2004b) and original work commissioned for this report.

¹⁹ For Pakistan, the existence of different poverty lines and different methods of updating the poverty lines for inflation has given rise to the co-existence of multiple sets of poverty estimates. All these estimates, however, show that poverty rose before 2001/02 and fell significantly thereafter.

Figure 2.1: Poverty headcount in recent years

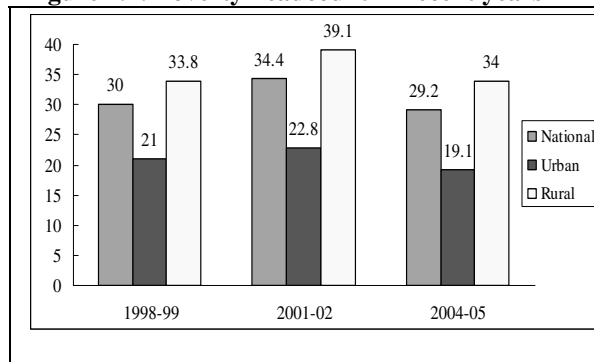
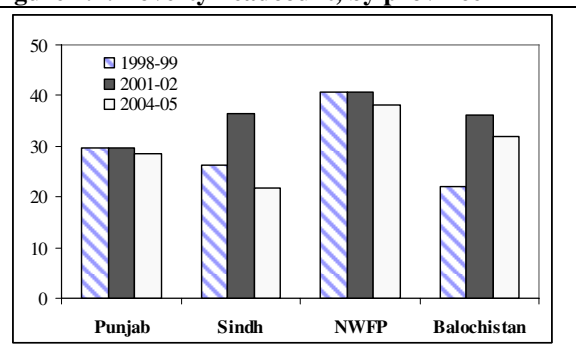


Figure 2.2: Poverty headcount, by province



Sources: World Bank staff calculations using nationally representative PIHS and PSLM data sets. Note that the estimated poverty rate in 2004/05 would be lower, at 24%, if the CPI was used as deflator instead of unit prices. The variation in poverty rates in Sindh and in rural areas are particularly striking.

Shocks as sources of risk

2.5 Despite large reductions in poverty, many households in Pakistan are poor and remain vulnerable to poverty. This report discusses vulnerability at some length to help scope out interventions that could help the country deal with the remaining burden of poverty and vulnerability. Poverty is a dynamic phenomenon, also at the level of the household. Although some households are both poor (non-poor) and likely to remain poor (non-poor) in the future because of their endowments and other characteristics, most others experience shocks that affect their income, consumption and assets and can trigger entry and exit from poverty. In addition, certain characteristics of the poor such as limited savings capacity and limited access to financial markets and safety nets make them more vulnerable to shocks and, consequently, diminish their capacity to escape poverty in a risky or uncertain environment.²⁰

2.6 This section explores these issues in detail. **We examine the question of risk by analyzing data on the incidence and impact of various types of shocks faced by safety net recipients/applicants,** (PSNS II, 2005). In doing this, we pay special attention to potential differences between ultra poor (those with consumption less than the food poverty line), poor (those with consumption above the food poverty line but below the national poverty line) and non-poor households (those with consumption above the poverty line) among this group, both in terms of exposure to shocks and their impact. As noted above, while the results from this survey are not nationally representative, it provides some insight that shocks are important for the poor and that their potential impact on consumption levels and other welfare measures can be substantial.

2.7 The main conclusion from this exercise is that **the introduction of risk significantly expands the set of households in potential need of assistance at a certain point in time.** And although in many ways vulnerable households are similar to poor households, there also exist important differences with potential policy implications.

Incidence of shocks

2.8 **The PSNS II survey showed that safety net recipient/applicant households suffered one or more major shocks during the three years prior to the survey** (PSNS II, see Box 1.1 and Appendix 1 for details on the data). Health and economic shocks appeared to be the most prevalent types of shocks, accounting for 54 and 28 percent of all such occurrences respectively, followed by shocks related to

²⁰ The concentration of individuals around the poverty line in Pakistan means that small changes in income can result in large changes in poverty.

natural disasters (7 percent), agricultural and demographic (family-related) shocks (4 percent each), and shocks related to law and order (3 percent).²¹

2.9 **Some of these shocks affected only the reporting household (i.e., idiosyncratic shock), while others affected a large demographic group or even a whole community (i.e., covariate or aggregate shocks).** According to the survey, the incidence of idiosyncratic shocks (health, family matters) was 58 percent, significantly higher than the incidence of aggregate shocks (economic and natural/agricultural). Although idiosyncratic shocks appear more prevalent by these estimates, natural disasters and aggregate shocks generally clearly remain important in rural Pakistan, as evidenced by the earthquake and by the recurring droughts and floods. World Bank (2002a), for example, found that 63 percent of villages had experienced drought within a five-year period. While aggregate shocks can exhaust the coping capacity of community-based informal safety nets, individual shocks (such as non-epidemic disease) can potentially be managed through community-risk pooling as different households are affected at different points in time.

Table 2.1: Incidence and Nature of Shocks

	Incidence of shocks	Health	Economic	Natural and agricultural	Family matters	Law and order
	% of all reported shocks					
All	64.8	54.6	29.2	10.0	3.5	2.6
Ultra-poor	62.3	62.3	22.5	10.4	2.8	2.1
Poor	65.3	55.3	29.8	8.6	3.6	2.7
Non-poor	68.1	43.4	37.7	11.1	4.5	3.3
Urban	71.5	58.9	32.9	3.6	3.2	1.4
Rural	61.3	51.9	27.0	14.0	3.7	3.4

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II), which is representative of safety net recipients/applicants and not nationally representative.

Note: Ultra-poor households are here defined as those with consumption below the food poverty line, poor households as those with consumption below the poverty line but above the food poverty line, and non-poor households as those who consume above the poverty line.

2.10 **The frequency and nature of shocks for this group varies with household characteristics and across areas of residence.** Approximately 62 percent of the ultra-poor and 65 percent of the poor sampled in PSNS II report to have suffered at least one shock in the three years prior to the survey, compared to 68 percent of the non-poor. Conditional on suffering a shock, however, ultra-poor and poor

²¹ Health shocks include illness, birth and death in the family, disability, surgical procedures and accidents. Economic shocks include change in employment status (e.g., job loss) and failure of own business. Shocks related to natural disasters include weather related events (e.g., drought, storms, flooding, landslides), pest attacks, fire, and earthquakes. Demographic shocks include marriages and other family events that may be associated with high financial costs. Finally, shocks related to law and order (or lack thereof), include theft and crime/violence, riots, land disputes, legal costs and police trouble. In interpreting these numbers it is important to note that the data was collected prior to the earthquake of October 8, 2005 (see Box 2.1 for more information on the earthquake) and that the PSNS focuses on households that benefited from or applied to social assistance programs, most of whom are poor. Moreover, rural Pakistan is often hit by drought, which can register as both an agricultural shock (for farmers) and employment shock (for laborers).

respondents²² were more likely to suffer health shocks than non-poor respondents, while the latter were more likely to suffer economic shocks than the former. In addition urban respondents are more prone to shocks than rural ones and, conditional on the occurrence of a shock, they are more likely to suffer health and economic shocks and less likely to suffer shocks related to natural disasters.

2.11 These differences can be attributed to a number of factors. First, poor households exhibit lower levels of access to health care and formal labor markets than non-poor households. Second, lack of adequate infrastructure in rural areas, combined with higher dependence on the agricultural sector for survival, makes them more prone to weather-related shocks.

Box 2.1: The Earthquake of October 8, 2005

The earthquake caused great devastation. The worst affected parts of four districts including Mansehra, Basham, Muzaffarabad and Bagh were completely wiped out. According to the joint ADB-World Bank Needs Assessment, approximately 73,000 people died and more than 70,000 have been severely injured or disabled. Many of the injured had amputated limbs or severe spinal cord injuries that left them paralyzed or disabled. A very large and disproportional share of deaths and injuries were sustained by schoolchildren and women. An estimated 15,000 people sustained spinal cord injuries or amputation, and many more suffered psychological trauma. Over 2.8 million persons lost their shelter.

The earthquake reminds us that the poor in rural mountain areas in particular face a considerable risk of loss of life or assets to natural disasters, small or large. There are few if any public programs offering prevention, mitigation, or coping with natural disasters — after the earthquake, an assistance package and delivery mechanism had to be designed largely from scratch.

Impact of shocks

2.12 Shocks experienced by this subset of households are generally associated with income and asset losses and, potentially, a decline in household consumption levels. These losses arise from the direct impact of the shock (e.g., foregone wages associated with the loss of employment) and the cost of coping with the shock after it happens (e.g., medical costs associated with an illness). The average total cost of a shock as reported by households in the PSNS II survey was Rs. 14,000 (or \$233).²³ This amount is equivalent to more than one third of average annual household expenditures, or five months of income from daily labor, of this group of households.²⁴

2.13 Total costs vary with the nature of the shock. These range from Rs. 42,000 for demographic or family-related shocks to Rs. 7,700 for economic shocks²⁵ (corresponding to approximately 100 and 19

²² We define ultra-poor households as those with consumption below the food poverty line, and the poor households as those with consumption below the poverty line but above the food poverty line. Data is from Phase II of Pakistan Safety Net Survey which focused on households that benefited from or applied to safety net programs; therefore not representative of the entire population of Pakistan.

²³ Based on Phase II of Pakistan Safety Net Survey and therefore not nationally representative.

²⁴ This amount is much higher than that reported in the PIHS or PSLs and can potentially be explained by several factors (i) PSNS II data pertain to the worst shock experienced by households over three years; (ii) self-reported total losses and coping costs of shocks include loss of employment and foregone income as well as out-of-pocket costs (the PIHS/PSLS only report out-of-pocket health expenditures. Finally, (iii) it is also important to note that the sample of both surveys is different; the PIHS is nationally representative, while the PSNS II is representative of safety net recipients/applicants the majority of whom are poor.

²⁵ Average costs of other shocks are: natural disasters, Rs. 20,700; law and order, Rs. 17,000; health, Rs. 13,000; agricultural, Rs. 12,300. As mentioned in the main text, these self-reported coping costs are defined differently and differ in magnitude from the out-of-pocket expenditures reported in the expenditure modules of PIHS or PSLs which, for example in the case of health expenditures, are no larger than 5 percent of total expenditures.

percent of annual household expenditures, respectively, for the low-income PSNS sample). The actual burden associated with each type of shocks also depends on how frequent they are. A better measure of the actual burden can then be calculated by multiplying the average cost times the frequency of each type of shock. Based on this measure health shocks account for most of the total shock costs to the PSNS respondents (51 percent), followed by economic shocks (20 percent), natural disasters (14 percent), family events (9 percent), agricultural shocks (4 percent), and law and order (2 percent). Within economic shocks, seasonal unemployment is widespread and very costly, with male workers on average idle for about two months in a year. This corresponds to an income loss of 17 percent, or nearly Rs. 6,000 per worker per year among the low income PSNS respondents. More stable employment would significantly reduce poverty.

2.14 Information on average costs or average total burden masks important differences between poor and non-poor and between urban and rural safety net recipients/applicants in the impact of shocks. Specifically lower income and consumption levels among the poor and in rural areas generally translated into higher relative costs of shocks for these groups, even in the absence of significant differences in the absolute costs of shocks between them and others. Shock-related expenses represent 54 percent of annual consumption for ultra-poor households in the PSNS (defined as those with consumption below the food poverty line), compared to 27 percent for poor households (defined as those with consumption below the poverty line but above the food poverty line) and 18 percent for non-poor households. Similarly, conditional on experiencing a shock, households in rural areas incur costs/losses equivalent to 37 percent of their annual consumption, compared to 30 percent for urban households (Table 2.2).

Table 2.2: Coping with shocks can be a high share of household expenditures

	Direct and indirect cost of coping with shock (% of annual household expenditure)*	Percent of households whose coping costs exceeded annual household expenditure
Income level		
Ultra-poor	54.3	15.7
Poor	26.8	5.4
Non-Poor	17.9	3.5
Location		
Urban	29.8	7.3
Rural	37.8	9.7
Total	34.7	8.8
Sample size	1,501	

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II), which is representative of safety net recipients/applicants and not nationally representative.

Note: Calculations include households that reported zero coping costs.

* Data pertain to the worst shock experienced by households over three years and self-reported total losses and coping costs of shocks include loss of employment and forgone income as well as out-of-pocket costs.

2.15 Finally shocks can also cause non-monetary losses. The PSNS II contains information on events triggered by shocks, such as increases in child labor or reduction in household food intakes. These changes are not conceived as coping strategies per se but rather result from other existing constraints (e.g., unavailability of spare adult labor or low pre-shock consumption levels). Eight percent of all shocks among the low-income households sampled for the PSNS resulted in a child being taken out of school, and 10 percent led to a child being put to work. These percentages were higher for more costly shocks (Table 2.3). Similarly, one third of all PSNS respondents subject to a shock saw their food intake decrease

as a consequence. This effect was more severe among ultra-poor households (36 percent) and households in urban areas (35 percent) due to higher levels of food insecurity associated with lack of access to land.

Table 2.3: Children withdrawn from school or put to work in response to shocks

Reactions to economic shocks (households with children that experienced an economic shock)			
	Children taken out of school (%)	Children put to paid work (%)	Average cost of shock (Rs.)
yes	7.7	10.3	17,441
no	92.3	89.7	8,650
<i>Total</i>	100.0	100.0	9,329
Families with children only (sample size: 1,460)			

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II) representative of safety net recipients/applicants and not nationally representative

2.16 **While this survey is not nationally representative, these figures suggest that the potential impact of shocks can be devastating both in the short- and the medium-term.** This is compounded by the fact that often coping mechanisms used by these households, although effective in the short term, severely jeopardize future livelihoods, as discussed below.

2.17 **Our discussion on shocks and their short- and long-term consequences makes it clear that a static notion of welfare such as that based on the traditional concept of monetary poverty is inadequate when it comes to informing social protection policy.** For this reason we spend some time below investigating the idea of vulnerability to poverty as an alternative and broader concept that captures both the idea of material deprivation and of exposure to risks.

Box 2.2: Regional and international evidence on the incidence and impact of shocks

Growing evidence suggests that most households across South Asia and other developing regions face similar risks. Surveys have shown that health, employment, and natural disaster risks are the top three risk factors in other South Asian countries. The relative importance varies—in Sri Lanka, natural disaster tops the list, while disease is the leading risk in Maldives and, by some evidence, in Andhra Pradesh, India, where drought is another major concern. In Afghanistan, employment risk is the single most prevalent risk, closely followed by disease and death. Indeed, there is mounting evidence from many developing countries that health shocks are among the most sizeable and least predictable shocks, imposing very large coping costs in terms of medical expenses and loss of earnings. While for other shocks, increasing the labor supply is a common response, this is often not possible when breadwinners face ill health, and medical costs are therefore compounded by income loss and an absence of coping options (see Kochar, 1995 for India). A detailed study in China also finds a substantial and significant reduction in income and labor supply due to health shocks. The loss in income is a consequence of a reduction in labor supply for the head of household, which is not compensated by increase in labor supply of other members. Health insurance in China appears to offer very limited protection—surprisingly out-of-pocket health care expenditures increase more for the insured than for the uninsured in response to health shocks (Wagstaff and Lindelow, 2005). In Indonesia, research by Gertler and Gruber (1997) using panel data found significant economic costs associated with illness, albeit more from income loss than from medical expenditures. The study found that households were unable to self-insure against illness. In fact, for illnesses that severely limit physical function, families were able to smooth less than 30 percent of the income loss from these illnesses. However, there is evidence that microfinance savings and lending institutions in Indonesia help families to self-insure consumption against health shocks (Gertler, Levine, and Moretti, 2003).

Vulnerability

2.18 **We define vulnerability as expected poverty, or the likelihood that households and individuals will remain or become poor in the (near) future.** Our method assumes that the variation in households' consumption over time is similar to the variation in household consumption across regions of Pakistan. The results are therefore only indicative, but can potentially help develop a better sense of who the vulnerable are (see Box 2.3). Although most ultra-poor and poor households will be considered vulnerable under this definition, the concept of vulnerability is broader than that of poverty and will therefore include some currently non-poor households with a high probability of falling into poverty. Similarly, it will exclude some currently poor households with a high probability of exiting poverty in the future given their endowments and other characteristics.

Box 2.3: Measuring vulnerability – A brief methodological explanation

In the absence of recent panel data representative of the whole of Pakistan, we employ a method for econometric estimation of vulnerability based on a single cross-section survey, following the methodology pioneered by Chaudhuri and others. The vulnerability estimation was carried out with the household data of the 2001/02 PIHS. The method consists in first estimating a consumption function based on cross-sectional survey data, and using the estimated model to generate household-level predictions of the probability of becoming poor in the future, defined in this report as a two to three year horizon. Households are classified as vulnerable if their probability of being poor is more than 50 percent. The crucial assumption behind this method is that the household inter-temporal variance in consumption can be proxied by the cross-sectional variance. This is a strong assumption—it amounts to saying that the variation in households' consumption over time is similar to the variation in household consumption across regions of Pakistan. The results should therefore be taken with a grain of salt: the results are potentially useful for establishing a profile of the vulnerable, but not as a point estimate of the level of vulnerability. Moreover, the method does not capture the potential impact of large aggregate shocks. We use the cross-section estimates at regional level to estimate the structure of variability, which we then use to derive an estimate of the vulnerability at inter-temporal level. After estimating the level of vulnerability for each household, we partition the sample according to predicted vulnerability and current poverty status.

Sources: Del Ninno, Vecchi and Hussain (2006), based on Christiansen and Boisvert (2000), Christiansen and Subbarao (2005), Chaudhuri (2000, 2001 and 2003), and Chaudhuri, Jalan and Suryahadi (2003). Further details of the estimation methodology are discussed in Appendix 2.

2.19 **By broadening our definition of welfare to account for the risk of future deprivation, we also gain some insight into the role and relative importance of structural and transitory poverty.** Specifically, we distinguish between the following three types of households according to their vulnerability status:

- Chronically poor or vulnerable to chronic poverty. Vulnerability among these households is the result of low levels of consumption. Their poverty is structural in that their basic characteristics make them likely to remain poor. They correspond broadly to the group of ultra-poor defined above.
- Transitorily poor or at risk of transitory poverty. Vulnerability among these households stems from income/expenditure volatility (most likely associated with positive/negative shocks). They are likely to transition in and out of poverty over time as a result of shocks and other factors. They overlap broadly with the group of poor (but not ultra-poor) defined above, but include also some who are not currently poor.
- Non-poor or infrequently poor. Levels of vulnerability to poverty are extremely low among these households since they enjoy both high levels of current consumption and low levels of future consumption volatility. They are the most secure households and, therefore, unlikely to fall into poverty.

2.20 Using a nationally representative survey (PIHS 2001/02), we find that approximately 56 percent of households can be classified as vulnerable when a 2-year horizon is considered, according to the above definition.²⁶ That is, in 2001/02 around 56 percent of households were either poor or expected to be poor at some point in the next two years. And vulnerability levels increase to 67 percent when a 3-year horizon is considered instead (although, as mentioned, not too much should be read into these point estimates due to the strong assumptions of the estimation methodology). The observed growth in the incidence of vulnerability as we move further into the future is a direct reflection of increased consumption risk—i.e., the probability of suffering (at least) one negative shock rises over time (Table 2.4).

2.21 Approximately half of Pakistan’s burden of vulnerability stems from vulnerability to chronic poverty, and the other half stems from vulnerability to transitory poverty, according to these estimates. One third of the population is estimated to be chronically poor or vulnerable to chronic poverty. Because this group is poor and likely to remain poor over time despite other developments, their relative numbers do not change as the time horizon expands from 2 to 3 years. An additional 24 percent of households are transitorily poor or vulnerable to transitory poverty. Because these households are exposed to high volatility in consumption, their relative numbers increase to 35 percent of the total as the time horizon expands from 2 to 3 years.

Table 2.4: Type and Incidence of Vulnerability
(in percent)

Category	Time horizon	
	3-year	2-year
Total	67.0	56.2
Total chronically poor or vulnerable to chronic poverty [Low consumption]	32.5	32.5
Vulnerable to chronic poverty	10.6	10.6
Chronic poor	21.9	21.9
Total transitory poor or vulnerable to transitory poverty [High volatility]	34.6	23.8
Vulnerable to frequent poverty	21.4	13.6
Frequent poor	13.2	10.2
Total non-vulnerable [High consumption, low volatility]	33.1	43.8

Source: Del Ninno, Vecchi and Hussain (2006).

Note: The estimated level of vulnerability is larger than the poverty rate since the vulnerable include households that are currently poor and expected to remain poor in the future as well as those who are not currently poor but face a larger than 50 percent risk of becoming poor in the next 2-3 years.

2.22 The question then arises as to what explains a household’s vulnerability status. To answer this question we develop a poverty and vulnerability profile with the understanding that such a profile could be an informative tool when it comes to designing, targeting and maximizing the impact of various social protection programs. This profile also includes some basic information on differences in education and health outcomes between the poor and the non-poor.

²⁶ Analysis is based on the PIHS 2001/02. Since the PIHS 2001/02 was collected, poverty and vulnerability have reduced, but remain at high levels, and the characteristics and composition of the poor and vulnerable are unlikely to have shifted in very major ways.

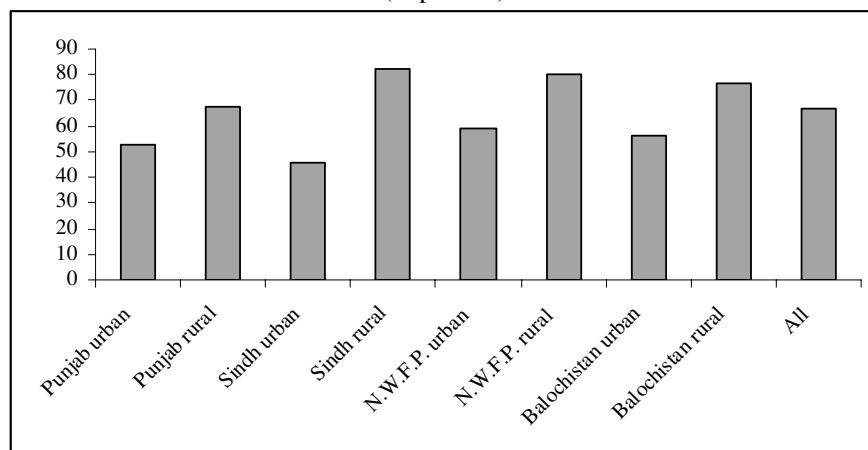
III. POVERTY AND VULNERABILITY PROFILE²⁷

A basic profile

2.23 The discussion is organized around three issues, location, household and demographic characteristics and other risk factors, and special attention is paid to potential similarities and differences between the determinants of poverty and the determinants of vulnerability. The discussion is drawn from the nationally representative PIHS survey.

2.24 **There are important differences in poverty and vulnerability levels across urban and rural areas and across regions.** Sixty-three percent of rural households are considered vulnerable (compared to 40 percent of urban households), accounting for almost 80 percent of the country's total number of vulnerable households, according to the vulnerability estimates. In addition, the incidence of chronic vulnerability is also higher in rural than in urban areas. Across regions, vulnerability rates are highest in rural Sindh, rural NWFP, and rural Baluchistan. They are lowest in urban Sindh and urban Punjab (Figure 2.3).²⁸ Chronic vulnerability follows the same regional pattern. Although these patterns mimic closely those arising from the discussion on poverty trends and incidence above, it is interesting to notice that most of the variation in vulnerability across areas of residence and regions can be explained by differences in chronic vulnerability—i.e., variation is explained by differences in structural rather than transitory poverty.

Figure 2.3: Vulnerability headcount
(in percent)



Source: Del Ninno, Vecchi and Hussain (2006).

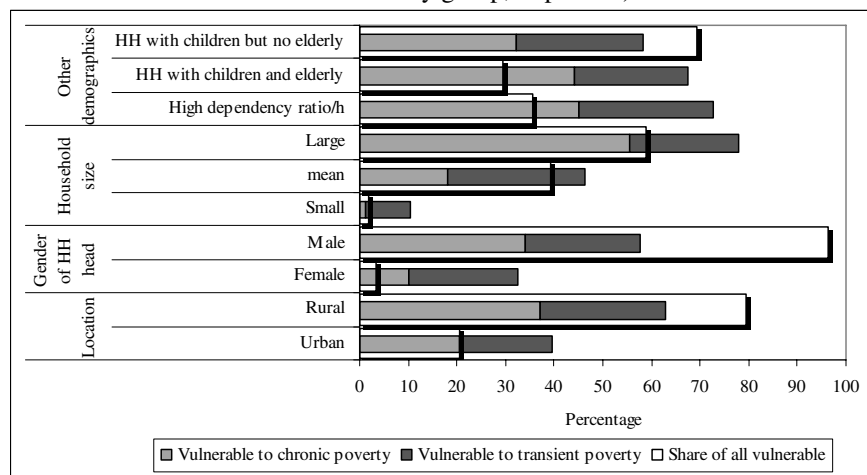
2.25 **Certain household and individual characteristics appear to be positively correlated with higher levels of poverty and vulnerability.** Larger households and households with higher dependency ratios are more likely to be vulnerable. Children aged 0 to 15 are the most vulnerable demographic group. They represent 43 percent of the population but make up 51 percent of those vulnerable to chronic poverty and 46 percent of those vulnerable to transient poverty. There is also evidence that vulnerability

²⁷ A full vulnerability profile is presented in Appendix 2, while the main results are summarized here.

²⁸ Compare to Figure 2.2 in which Sindh shows the greatest variation over time in poverty rate, perhaps because of aggregate shocks such as droughts. The vulnerability estimation used here does not capture the impact of such shocks and for this and other reasons yield results that differ from provincial variation in poverty rates.

is high among socially excluded groups, defined along lines such as physical disability,²⁹ religion, language, and *biraderi* or social status. As before, some of the main factors (large household size, presence of children, disability) identified as correlates of vulnerability are also correlates of poverty. There are, however, some interesting differences. For instance, female-headed households are significantly less vulnerable than male-headed households, contrary to what a more traditional poverty profile may have suggested (female-headed households often benefit from remittances from absent males). Similarly the elderly do not appear to be any more vulnerable than adults of working age (Figure 2.4).

Figure 2.4: Vulnerability by household characteristics
(Share of group estimated to be vulnerable and share of total vulnerability accounted for by group, in percent)



Source: Del Ninno, Vecchi and Hussain (2006).

Note: HH=Household

2.26 Household employment status also correlates with poverty and vulnerability. Households whose heads work in the informal sector and in rural areas tend to be poorer and more vulnerable than others. The Pakistan Labor Market Study (World Bank, 2006f) finds that formal employment is low in Pakistan and informality is pervasive and has been growing (from 65 percent of non-agricultural employment in 2001/02 to 70 percent in 2003/04, see Box 2.4; almost 81 percent of all workers are informal). According to the labor force survey, average earnings for salaried employees in 2003/04 were below Rs. 4,200 (or \$70 per month) or Rs. 166 (approximately \$3 per day), and place a typical family of six with one earner below the poverty line (Table 2.5). Average wages of self-employed workers are much lower. In PSNS, the *average* wage received by workers belonging to the bottom quintile was Rs. 86 per day (or \$1.4 per day). Aside from low wages, wage uncertainty is high. Most workers do not work all year long, due to the seasonality of rural work and chronic underemployment. According to the PSNS, rural self-employed and wage workers have several “inactive” months in a year where they are mostly unemployed, with some 40-60 idle days per year.

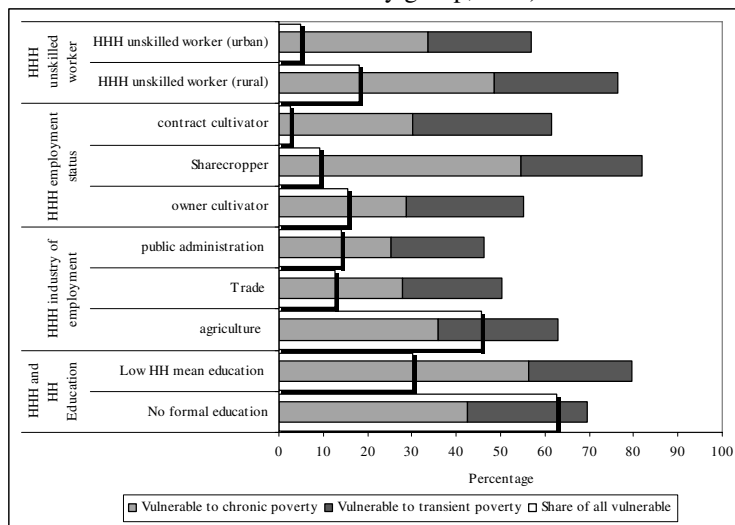
²⁹ The number of persons with disabilities and the causes of disability in Pakistan are not well known. The social safety net survey found very low incidence of any type of disability, apparently because of underreporting. There is an often-quoted standard global WHO estimate for the incidence of disability, broadly defined, at 10 percent. Other observers put the incidence of disabilities at 4-8 percent in most developing countries, with perhaps 12 percent disabled under the broadest of definitions. Persons with disabilities have lower education and income levels than the rest of the population. They are more likely to be poor than the non-disabled, and they are less likely to have savings and other assets. The poverty-disability relationship goes two ways—disability adds to the risk of poverty, and conditions of poverty increase the risk of disability.

Table 2.5: Key Labor Market Indicators for Pakistan (2003/04)
(in percent)

Labor force participation (refined participation rate)	47.1
Unemployment rate	7.7
Informality (share of all workers)	80.8
Average monthly earnings of salaried workers	Rs. 4170 / \$70

2.27 **Ownership of livestock and agricultural land are closely associated with poverty in rural Pakistan.** The poorest quintile of the rural population accounted for only 10 percent of the total estimated value of livestock in 2001/02, compared with 36 percent for the top quintile. Similarly, households with no land constituted 60 percent of the rural population in 2001/02, but accounted for 76 percent of those in the bottom quintile. Not surprisingly, households headed by individuals employed in the agricultural sector, sharecroppers in particular, exhibit high levels of vulnerability (Figure 2.5).³⁰

Figure 2.5: Vulnerability by education and employment
(Share of group estimated to be vulnerable and share of total vulnerability accounted for by group, in %)



Source: Del Ninno, Vecchi and Hussain (2006).

Note: HHH=Head of Household

³⁰ Special surveys of informal sector workers have revealed that they work long hours, in some case beyond 60 hours a week (Kemal and Mahmood, 1993).

Box 2.4: Labor market outcomes in Pakistan

Paid employment is scarce in Pakistan, where labor supply has grown faster than labor demand for some time. Thus, between 1984/85-1993/94, the labor force grew by 2.4 percent per annum while employment grew by 2.3 percent per year, while from 1993/94-2003/04 the rate of labor force expansion speeded up to 2.7 percent per annum and employment grew by only 2.4 percent. Open unemployment peaked at 8.3 percent in 2001/02, before declining to 6.2 percent in second quarter of 2005/06.

The quality of most jobs is low: wages are low and declined in real terms during much of the 1990s (they have since started to rise); informality is pervasive and spreading, accounting for 70 percent of non-agricultural employment, and 55 percent of wage employment,³¹ job security is non-existent for a large and growing majority of workers, as the share of workers with job regularity fell from 55 percent in 1997/98 to 50 percent in 2003/04 as the share of government employment declined; and most workers are either self employed or employed in the informal or agricultural sectors, often at very low productivity. The share of workers employed in manufacturing and mining today, at 13.8 percent, is the same as it was 20 years ago.

Source: Pakistan Labor Market Study (World Bank, 2006f).

2.28 Poverty and vulnerability are also associated with access to human capital, which bears a close connection with current and future income and thus poverty. The probability of being poor decreases as the education of the household head increases. This association is stronger in urban areas than in rural areas, particularly for higher levels of education. Households headed by individuals with low levels of education or skills exhibit also higher levels of vulnerability and chronic vulnerability than other households.

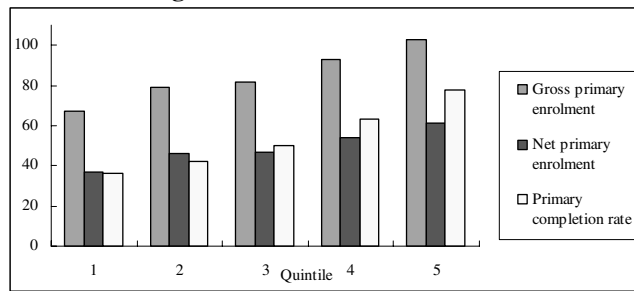
2.29 It is important to point out that the relationship between poverty, vulnerability, employment and human capital (or the lack thereof) also extends to children. Working children, children not enrolled in school and those who are only partially immunized appear to be more vulnerable than others. In the case of children, however, poor human capital outcomes are likely to be the result of high vulnerability rather than the other way around, suggesting a perverse relationship between current and future poverty and vulnerability as worse off households lack the means to invest adequately in their children and public support falls short of compensating for these deficiencies. This is perhaps not surprising given the poor health and education outcomes for poor children in Pakistan, a function of both inadequate quality and limited access to education. In many countries (e.g., Bangladesh, Turkey, Brazil) the inability of public or private health and education systems to reach the poorest households have induced targeted cash transfer programs to make income support payments conditional on enrollment in health/nutrition and education programs. Many such experiments are also underway in Pakistan (see Chapter 3).

³¹ Defining the informal sector as firms with less than 10 workers and engaged in non-agricultural, non-governmental activities.

Box 2.5: Education and Health Outcomes in Pakistan

Education outcomes remain far below their potential in Pakistan. Primary enrolment and completion rates are relatively low in Pakistan, compared to countries with similar levels of income. Primary gross and net enrolment rates have improved but in 2005 still only stood at 86 and 52 percent, respectively. The large differences between net and gross enrollment rates are indicative of problems of late entry into school and grade repetition. Enrolment and completion rates are twice as high among better off households as among poor households demonstrating the strong association between economic status and educational attainment. Finally, enrolment rates are higher for boys than girls and these differences are larger among rural and poor households. These differences can also be observed at the secondary level. Finally, in a context of low quality public schooling, differences in education outcomes between rich and poor are compounded by differences in access to private schooling. Private schools account for 24 percent of primary enrollment, but 48 percent of the enrollment of the 5th quintile and just 9 percent for that of the 1st quintile.

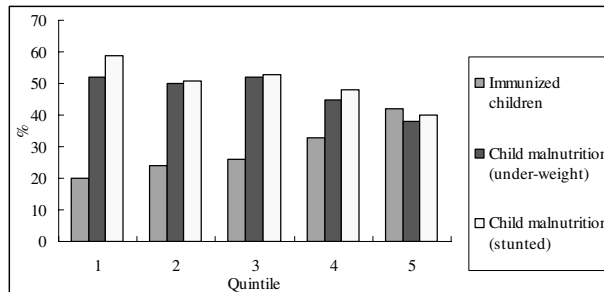
Figure 2.6: Education outcomes



Source: Staff estimates using 2002/02 PIHS data

Pakistan has seen some improvement in child health and nutrition indicators, but significant challenges remain. The infant mortality rate (IMR) declined from 101 per thousand births in 1995-96 (for births occurring during 1991-93) to 89 in 1998/99 (for births during 1995-97), and to 82 in 2001/02 (for births during 1997-99). Although different surveys yield conflicting trends, according to the National Nutrition Survey the percentage of underweight and stunted children declined from 51 to 41 percent and from 41 to 31, respectively, between 1985-87 and 2002/02. Important challenges remain however. In contrast with the developments described above, the last ten years have witnessed deterioration in the (full) immunization rate. This suggests that improvements in health outcomes may have been driven by factors other than better access to and quality of health services. In addition infant mortality, malnutrition and immunization rates are still significantly higher in rural areas and among the poor. And the same geographic and rich-poor gaps are visible when it comes to maternal health outcomes, such as prevalence of pre- and post-natal consultations and of assisted births.

Figure 2.7: Child Health Outcomes



Source: World Bank (2005b) and staff estimates using PIHS (2001/02) for immunization rates and PSES (2000/01) data for malnutrition rates.

IV. INFORMAL RISK MANAGEMENT STRATEGIES

2.30 Given the evidence presented above on the incidence and impact of shocks, how do households cope with these shocks? **Generally speaking, households can employ ex-ante strategies aimed at risk prevention and mitigation, and ex-post strategies aimed at correction and coping after a shock has occurred.** Ex-ante strategies include savings, insurance, migration, and employment (and hence income) diversification.³² The ability of most households (and particularly poor households) to resort to these strategies, however, is severely limited by both financial, insurance and labor markets underdevelopment (World Bank, 2002a and 2004a), and the high opportunity cost of holding precautionary savings or insurance. As a result of limited ex-ante risk management, a sizeable share of uninsured risk remains. Ex-post strategies can be divided into asset-based strategies such as use of existing savings and other assets, insurance and financial markets, and behavior-based strategies such as increased labor supply and reduced consumption. Assistance, both by private and public agents, also plays an important role. As we will discuss below, the consequences of choosing a particular strategy, in terms of both its short-term effectiveness and its long-term impact of household welfare, vary significantly across households. For the discussion in this section, we again turn to the survey of safety net recipient/applicant households (PSNS II), which contains information on risk management strategies of these households. While it is important to note that the results are not nationally representative, they still provide valuable information on the strategies followed by this particular group, comprised of largely poor households.³³

2.31 **The survey contains information exclusively on ex-post strategies for sampled households and considers four broad categories: (i) reduction in household net worth (i.e., dis-saving), (ii) expansion of household labor supply, (iii) reduction in consumption, and (iv) use of assistance.** Information is also collected on how these various strategies were implemented. For instance, in the case of reduction of household net worth a distinction is made between the use of loans/credit, the sale of assets/durable goods, and the use of existing savings. Similarly, information is collected regarding changes in labor market participation (both of adults and children) and in hours worked. More than 50 percent of the households sampled for the PSNS II, who were subject to a severe shock (mostly low income), saw their net worth decline as a consequence; 11 percent increased labor supply, 10 percent received assistance and 1 percent reduced consumption. The remaining 24 percent declared to have done nothing in response to the shock.

2.32 **The use of a particular strategy is a function of the nature and magnitude of the shock and of available coping options.** Use of existing savings and assets and of credit appears to be more common when law and order or health shocks occur; increased labor supply is used more often in the case of family-related or health shocks; and assistance is required more frequently when a health shock happens. Similarly, inaction is most prevalent in the case of economic shocks and least in the case of health shocks. In addition more “informal” strategies such as using savings, shopkeeper credit, and assistance from friends and relatives are more common when less costly shocks occur, while more formal strategies such as selling major assets, borrowing from a moneylender, and requesting government assistance are used in the case of costly shocks.

³² Migration is a common strategy for coping with risks, with more than one in four rural Pakistani households reporting at least one migrant (Mansuri, 2006a).

³³ See Appendix 1 on the sampling of the PSNS data used in this section.

Table 2.6: Coping Strategy by Nature of Shock

	All shocks	Health	Economic	Natural and agric.	Family matters	Law and order
	Percentage of households that used each strategy					
Reduction in net worth	53.5	56.8	46.0	56.5	50.0	62.5
Use of savings/assets	28.3	25.0	32.1	28.9	29.6	52.5
Loan or credit	25.2	31.8	13.9	27.6	20.4	10.0
Increased labor supply	11.2	13.7	6.5	9.9	14.8	12.5
Decreased consumption	0.9	1.2	0.7	-	1.9	-
Received assistance	10.2	14.0	6.1	3.3	11.1	-
Did nothing	24.8	15.1	41.3	30.9	20.4	25.0

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II), which is representative of safety net recipients/applicants and not nationally representative.

2.33 Responses to shocks also vary by household. **Ultra-poor and poor³⁴ households in this group are likely to use behavior-based strategies such as increasing labor supply or reducing consumption, while non-poor households are more likely to use asset-based strategies such as drawing down existing savings or requesting a new loan or credit.** The same is true for rural and urban households. In addition, ultra-poor households and rural households are more likely to receive assistance than others.

2.34 **Because there are limits to the effectiveness of behavior-based strategies used by the poor, these differences have important implications.** Individuals can only work so many hours and consumption cannot fall below subsistence levels. Households that are closer to these limits at the time of the shock will thus find it harder to overcome its effects. Because these households tend to be the neediest this could create a vicious cycle of poverty and vulnerability.

Table 2.7: Use of Coping Strategies across Households

	Reduced net worth		Increased labor supply	Decreased consumption	Received assistance	Did nothing
	Use of savings/assets	Loan or credit				
Total	28.3	25.2	11.2	0.9	10.2	24.8
Ultra-poor	23.4	31.0	13.8	1.2	13.7	18.3
Poor	33.8	21.6	11.1	1.0	6.5	26.2
Non-poor	28.3	21.7	7.8	0.5	9.9	31.8
Urban	31.5	28.1	7.0	1.2	9.5	22.5
Rural	26.3	23.3	13.9	0.7	10.6	26.2

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II), which is representative of safety net recipients/applicants and not nationally representative.

Note: Ultra-poor households are here defined as those with consumption below the food poverty line; poor households are those with consumption below the poverty line but above the food poverty line; non-poor households consume above the poverty line.

³⁴ Ultra-poor households are defined as those with consumption below the food poverty line; poor households are those with consumption below the poverty line but above the food poverty line; non-poor households consume above the poverty line.

Effectiveness and potential impact of various coping strategies

2.35 We argued above that **the choice of a specific coping strategy had important short- and long-term consequences, particularly among households with low consumption levels and limited access to markets.** Spending precautionary savings and borrowing from friends and relatives may not carry drastic consequences. However, selling or mortgaging of land, house, and productive assets can jeopardize households' livelihoods. Expanding the labor supply of adults is normally quite acceptable, while sending children to work can erode their human capital. Reducing consumption temporarily in response to an adverse event is rarely a problem for the well-off, whereas for the poor, lower consumption often translates into lower food, health and education expenditures. In fact, conditional on experiencing a shock, the ultra-poor safety net recipient/applicant households in the PSNS II are twice as likely to resort to child and bonded labor and four times as likely to sell their crop in advance as the non-poor, which may explain why it is so hard to escape poverty for these households.

2.36 **The (short-term) effectiveness of various strategies for this group of households appears to be fairly limited and varies with the type of shock.** Approximately 43 percent of those reporting a shock declared that they had not recovered from it at the time of the survey, compared to 20 percent who declared to have fully recovered. The share of those who declared not to have recovered yet increases with the estimated costs of the shock, and is significantly higher in the case of health shocks.

2.37 **In addition the use of certain coping strategies can have harmful consequences over the medium term.** The lack of retrospective questions makes it hard to assess the medium term impact of different coping strategies accurately. Instead, we use other data to provide a general discussion on the expected medium term effects of household coping strategies in the belief that this discussion is informative when it comes to policy making in the area of social protection.

2.38 **Reduction in net worth.** More than half of all surveyed safety net recipient/applicant households (PSNS II) used this strategy to cope with shocks. About 50 percent of them used existing savings and assets, an additional 40 percent borrowed money, mostly from friends and relatives, and the rest took a mortgage on their house or land plot. The use of savings and, particularly, assets can have different consequences depending on whether they were held for precautionary or productive reasons. While the use of the former would indicate that the households have some self-insurance capacity, the use of the latter (i.e., a house or a plot of land) would suggest that the household is under extreme duress and forced to resort to extreme coping measures with potentially damaging long-term impacts.³⁵ Similarly the implications of borrowing can be very different depending on whether the money is obtained from friends, shopkeepers, landlords and moneylenders, or institutional lenders.³⁶ Although borrowing is more common in urban than in rural areas, the ultra-poor are as likely to borrow as the poor and the non-poor among the sampled households.³⁷ However, the sources of loans differ between groups. Ultra-poor in rural areas are more likely to borrow from landlords. These loans are part of the 'patron-client' relationship between rural landlords and the rural landless or near landless; a relationship that on the one hand provides a (minimal) safety net for the ultra-poor 'clients' but on the other hand can be exploitative (Aleem, 1990). Landlords often act as moneylenders, charge high, sometimes exorbitant interest rates,

³⁵ See Kochar (2004) and Adams (2000) for more detailed studies on the use of assets and savings as a coping strategy and its consequences.

³⁶ People demand credit, regardless of whether they experienced a shock. Seventeen percent of households interviewed by the PSNS had taken a loan in the 12 months prior to the survey, almost all from informal sources. Most loans were made by friends and relatives (63 percent) with landlords (15 percent), shopkeepers (12 percent) and commercial/institutional sources (3 percent) providing most of the remainder.

³⁷ Based on Phase II of Pakistan Safety Net Survey and not nationally representative.

and may take over the land, house, or assets of debtors when they fall into arrears (Kabeer, Mumtaz, and Sayeed, 2006). There is circumstantial evidence that such debt traps can result in bonded labor (see Box 2.6), and solid evidence that emergency asset sales and asset forfeiture due to loan default play a role in the unequal distribution of land by accumulating land in the hands of rural landlords and moneylenders (Heltberg, 1998). Distress asset sales also lead to underemployment when workers lack the land and animals that are complementary to their labor.

Box 2.6: Coping with multiple misfortunes – The story of Tariq

Tariq was a farmer in a small village in rural NWFP. He owned 10 *kanal* of land with a small stream running through it. From this land, he was able to feed his family, earn a small income, and send his sons to school. When his wife fell ill, he was faced with medical bills beyond his immediate ability to pay, and his brother, sister and neighbor lent him some money. Then it rained for five days. His house, made of mud-bricks and straw, started leaking, and on the fourth day the roof collapsed pulling with it two side walls. The house was destroyed and his donkey killed, but Tariq thanked God that no one was hurt and that his family was safe.

The cost of rebuilding the house was beyond his capabilities because he had already exhausted his family's and his neighbors' capacity to help. His only alternative, he felt, was to take a loan from the local money lender and largest land owner of the village, Malik. Malik charged 18 percent interest, and wanted monthly payments. Tariq, his brother, and his neighbors rebuilt the house, during which time many jobs on the farm were left unattended, they were selling neither milk nor crops, and their income declined. By the end of the first month Tariq was unable to pay the first installment. For this default on the loan terms, Malik increased the interest rate to 21 percent, the first month's interest was added to the capital, and a fee imposed for non-payment. Tariq's debt had grown considerably, he still had not repaid the debt to his neighbor, his income had declined, and he had no cash to buy seeds. When his wife became ill again, he could not afford to take her to the doctor.

Tariq sold the cows, which gave him a small cash injection, but which deprived him of a source of income from selling milk and also a source of food for his family. He sold his wife's two gold bangles. Then Malik suggested that Tariq's oldest daughter, aged 13, work as a domestic servant in his house. Her wage would go toward servicing a share of the interest on the debt. However, her share of the household and farm chores at home would then have to be picked up by her younger sister, who was eight years old.

As the debt grew larger each month by compounding interest, Tariq's second daughter went to work as a domestic servant too. Then his two sons left school and found work cleaning dishes in the bazaar earning Rs. 50 a day plus a meal each. Even with this additional income, the family was unable to service the debt.

Malik then took possession of Tariq's land and house as a payment toward the debt. Malik paid Tariq a very small amount, much less than what Tariq estimated the land to be worth, and the debt was still largely unpaid. Tariq was now working as a tenant farmer on land that used to be his, and both his daughters were also working for the same man and their wages going directly to paying the debt, which nevertheless continued to grow.

When Tariq was killed in an accident, his older son inherited the debt, and he became bound to work for Malik until the debt is fully repaid. Tariq's son is now 28 years old, and he, his brother and sisters, and their spouses and children are still working as tenant farmers for Malik's family. None of them receive wages directly because the debt has still not been repaid.

Source: Schlichting (2005).

2.39 **Increased labor supply.** Expanding the number of hours worked is the second most common coping mechanism for safety net respondents (PSNS II).³⁸ This can be achieved by taking an extra job, working longer hours in an existing occupation, and increasing labor force participation among household members, sometimes in the form of bonded and child labor (see Box 2.7). The capacity of households to successfully increase labor supply depends on both household and labor market characteristics. As noted

³⁸ Ibid.

above, migration is very common in Pakistan, and has been found to exert a large influence on children's education and nutrition, especially for girls, playing a positive role in cushioning child human capital from shocks (Mansuri, 2006a, 2006b). Poor households and those with low levels of education are less likely to find formal, well-paid employment than their non-poor, more educated counterparts. There is also evidence that caste and other social restrictions may limit access to better jobs among certain groups (Kabeer, Mumtaz, and Sayeed, 2006), while the lack of land, credit and other assets curtails options for self-employment. In addition, employment creation has been weak in recent years, the quality of the average available job is low (both in terms of pay and security), and informality is rampant. The combination of non-marketable household characteristics and weak labor market performance implies that the effectiveness of this strategy as a coping mechanism is somewhat limited among ultra poor and poor households, forcing them to resort to extreme and potentially harmful options. For instance, falling into bonded labor is particularly common among the rural poor and those with no assets (World Bank, 2002b).³⁹ Bonded laborers are tied by debt to a particular employer. They work at very low wages and sometimes only for food and clothing in order to pay back debts at very high interest rates. Debts are sometimes inherited, trapping several generations of the family in bonded labor. Bonded laborers are an extremely poor category of households with little chance of escaping poverty.

Box 2.7: Child labor as a coping strategy – The story of Rukhsana

Rukhsana used to go to school. When she was 11, her father had an accident and he has not been able to work since. The family was not poor, but not comfortable either. After her father's accident, their living standards rapidly declined. First, they sold their assets including their goats and her mother's jewellery. Rukhsana and her siblings started working and were pulled out of school. Then they sold their land and house, and spent a few years being moved from one relative's house to the next. The children were never re-enrolled at school.

Rukhsana worked as a domestic servant. Her employer started using her as a dancer at his business functions. Eventually she was required to provide sexual services as part of this work. Now, she is a full-time sex worker. She cannot pinpoint the time at which she became a prostitute, and baulks at the label, preferring to call herself a dancer. Rukhsana says that because she is not a sex worker, she does not need to take special precautions, does not use condoms, nor visits health clinics. Her parents believe that she works in an office, in a well-paid, respectable job. She brings home good money and the family is now able to rent a small space of their own. She has been able to enroll her youngest brother in school, is able to cover her father's substantial medical costs, and supports the whole family.

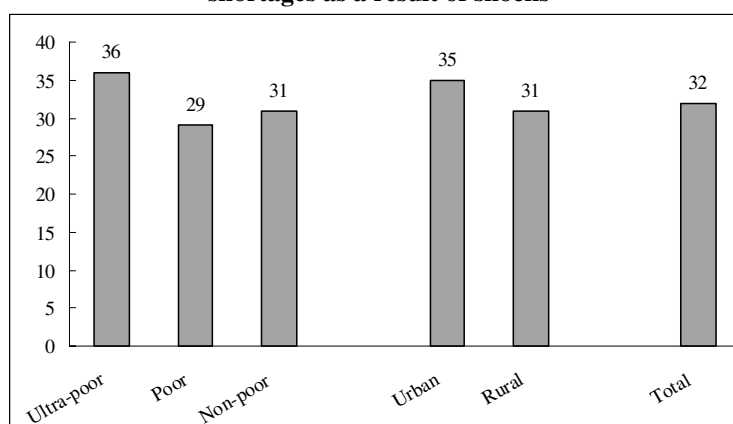
Source: Schlichting (2005).

2.40 **Reduced consumption.** Although only a small percentage of safety net recipient/applicant households who suffered a shock (approximately 3 percent of the PSNS II respondents) reported cutting back on household expenditures, the fraction of households that resorted to reduced consumption as the main coping strategy is significantly higher among the ultra-poor and the poor than among the non-poor (Figure 2.8). Because these are households whose level of consumption is already low, the potential consequences of this action are particularly worrisome. In fact there is evidence that uninsured risk contributes in a major way to food insecurity as food is the short-term variable cost over which households can exert the most control, making it the first target when cutting expenses. Commonly households reduce the quality and diversity of their food first and, if this is not enough to make ends meet, they also decrease the frequency of meals and redistribute food toward the principal earner and away from women and girls. This can result in undernourishment or micronutrient deficiency among

³⁹ Although estimates of the extent of bonded labor vary widely (see World Bank, 2004a), available studies indicate that bonded laborers are concentrated in rural areas of southern Punjab and northern Sindh and that landless sharecroppers and brick kiln.

certain household members, including children and pregnant and nursing mothers, with devastating effects on their physical and cognitive development (World Bank, 2003; Schlichting, 2005).

Figure 2.8: % Safety net recipient/applicant households experiencing food shortages as a result of shocks



Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II) representative of safety net recipients/applicants and not nationally representative.

2.41 Households' capacity to implement the three strategies discussed so far depends almost exclusively on the ability of household members to change their behavior. Households in need, however, often look for help outside their own private sphere by requesting assistance from other private agents or from the government. We discuss below the role of private assistance, paying special attention to its effectiveness as a risk coping strategy, and postpone the discussion on government assistance to Chapter 3.

2.42 **Received assistance.** Conditional on suffering a shock, 10 percent of the households surveyed in PSNS II turned to private (75 percent) or public (25 percent) assistance as their main coping method (more may have relied on assistance as a secondary coping method).⁴⁰ The ultra-poor households were more likely to use assistance (mostly private) for coping (13.7%) than the poor (6.5%) or non-poor (9.9%). Further analysis of the assistance data in the PSNS provides interesting insights that can help us assess the potential effectiveness of private assistance:⁴¹

- Private assistance is quite generous compared to household income. Conditional on receiving private assistance, donations to ultra-poor and poor households in the 12 months prior to the survey were equivalent to 42 and 20 percent of household expenditures, respectively (Table 2.8).

⁴⁰ According to the Pakistan Centre for Philanthropy (1998), Pakistani households and organizations give and receive a substantial amount of private charitable assistance. A survey carried out by this organization in 1998 showed that the value of cash, in-kind and time contributed towards private philanthropy in that year equaled around Rs. 70 billion, of which 42 percent was cash, 16 percent the value of in-kind contributions, and 42 percent the imputed value of time volunteering. Fifty-four percent of this philanthropic assistance went to individuals, the rest to organizations (see www.pcp.org.pk).

⁴¹ The Pakistan Safety Net Survey contains detailed information on private and NGO assistance, even where this assistance was not the main method used to cope with a shock. The survey focuses on cash and in-kind assistance, and no effort is made to quantify the time spent volunteering. These estimates are based on data from Phase II which focused on households that benefited from or applied to safety net programs and whose respondents are mostly low income and therefore not representative of the entire population of Pakistan.

- Private assistance appears complementary to public assistance. Larger amounts of private assistance go to beneficiaries of public programs, especially Zakat, suggesting that public assistance on balance does not crowd out private assistance.
- Still, private assistance does appear to reach some of those in need. Expenditure inequality, measured by the Gini coefficient, falls by 1.9 percent from 0.324 to 0.318 once net private transfers are taken into account.
- Private assistance was often relied upon for smaller shocks, while government assistance played a more important role in the case of catastrophic losses.
- However, private assistance is concentrated at the time of religious festivals. Seventy one percent of all assistance given during the 12 months prior to the survey was collected during Eid or Ramadan.
- Private assistance tends to be individual-based rather than institution-based, and thus has some reciprocal elements. Friends, neighbors or community members account for 75 percent of all private assistance, compared to less than 10 percent for charities, foundations, or religious groups.

Table 2.8: Adequacy of Private Assistance
(private assistance received 12 months prior to survey)

	Average annual private transfers received (Rs), conditional on receiving	Private transfer receipts in % of household consumption	Private transfer receipts as % poverty line (Rs. 937 per month per person) for a family of six	Private transfer receipts as % of average agricultural wage
Ultra-poor	5664	42	8.39	21.0
Poor	8692	20	12.88	32.2
Non-poor	5523	13	8.18	20.5
Total	6680	25	9.90	24.7

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (PSNS II) representative of safety net recipients/applicants and not nationally representative.

2.43 **These basic facts suggest that, although private assistance is widespread and significant in magnitude, there are limits to its effectiveness in combating poverty.** First, clustering of private assistance at times of religious festivals makes it hard for the poor to meet emergency needs that arise at other times of the year. And though in principle donations could be saved, the fact that almost one-third of private assistance is in-kind makes it hard. Second, the fact that most assistance takes place at the local level and between households implies that aggregate shocks, such as natural disasters, can overwhelm the coping capacity of a particular community. Finally, the principle of reciprocity can cause exclusion of the very poorest, who have little to give back, or of those who do not belong to networks or communities with the capacity to support them.

V. CONCLUSIONS

2.44 The discussion in this chapter has tried to alert the reader to a series of issues that we consider important when thinking about designing and implementing effective poverty reduction and social protection programs. First, we have shown that the poor suffer from material deprivation, both in their physical and human assets, particularly in the access to education and health services. Given that human capital accumulation is one of the most effective poverty exit strategies in the medium-term, persistent differences can jeopardize social mobility and perpetuate inter-generational poverty. Second, results from the PIHS survey suggest that the poor not only suffer from material deprivation, but are also exposed to a significant amount of (income) risk and uncertainty. Of concern is the large share of informal sector workers in Pakistan and their families who face considerable income risk because of limited access to social security or basic employment protection. Third, due to their restricted savings capacity and asset base, we have shown that the poorest among safety net recipient/applicant households (PSNS II) are often

not capable of self-insuring against risk and have to cope with the impact of shocks once these occur. Fourth, we find that the poorest among this group are likely to rely on behavior-based coping strategies such as increasing labor supply or reducing consumption (both of which affect their children), which may have potentially harmful long-term impacts. Finally, given the presence of risk, we have advocated for the use of a broader definition of welfare, based on vulnerability to poverty. This definition allows us to differentiate between current poverty and the risk of future poverty and between structural and transitory poverty.

2.45 Following from the above, an effective social protection system would then have to achieve the following: (i) provide (minimum) income and other support for those with a small probability of exiting poverty (i.e., the chronic poor); (ii) support the implementation of mechanisms and strategies to exit poverty among those with a higher likelihood of succeeding, including increased access to economic opportunities and the promotion of human capital accumulation—particularly of children; and (iii) support (directly or indirectly) the implementation of effective risk mitigation strategies to help households smooth income over time. In addition, high exposure to risk and high vulnerability incidence for particular segments of the population (e.g., informal sector workers) requires that, to the extent administratively and fiscally feasible, the design and nature of social protection programs must be such as to allow the system to quickly react to individual and aggregate shocks. This implies that programs must be capable of deploying assistance at short notice and that they must be able to expand and contract their beneficiary base over time.

2.46 The next chapter critically evaluates the extent to which Pakistan’s social protection system meets these challenges and provides help to those most in need. For this purpose the chapter examines both the social protection system as a whole and the various programs that integrate it, and analyzes if their design and implementation are the most adequate in terms of effectively providing income support and minimizing income volatility.

CHAPTER 3. FIGHTING POVERTY AND VULNERABILITY: PAKISTAN'S SOCIAL PROTECTION SYSTEM

I. INTRODUCTION

3.1 How much does Pakistan spend on social protection? Is the combination of existing programs adequate given the country's poverty and vulnerability profile? Are programs managed effectively? Do resources go to those who need them the most? Are benefits sufficient to achieve programs' goals? This chapter presents a detailed discussion on Pakistan's social protection system to try to answer these and other related questions. In doing so the chapter aims to provide the reader with sufficient knowledge regarding existing programs so as to allow her to evaluate the system's overall efficiency and efficacy as well as to assess its adequacy given the challenges identified in Chapter 2. In this sense the chapter can be viewed as both the core of the report and a bridge between the diagnosis presented above and the policy agenda developed in Chapter 4.

3.2 The discussion is structured so that the reader moves from the big picture to the specifics of various programs. Section II presents an overview of Pakistan's social protection expenditures and Sections III-IV provide information about existing programs. For this purpose programs have been divided into two categories according to their nature or main objective: (i) *safety nets* (a) programs that provide income and other support to the poor; (b) programs that promote sustainable poverty exit strategies; (c) programs that help households cope with aggregate shocks; and (ii) *social security*, or contributory 'insurance' programs. As noted in Chapter 1, the first set of programs help individuals *cope* with risk after the shock has occurred, while the latter allow households to *mitigate* risks prior. Finally Section V discusses the adequacy of the existing system and identifies the challenges ahead. The analysis in this section relies on the Pakistan Safety Net Survey (PSNS) I and II. PSNS-I is nationally representative while PSNS II is a survey of safety net beneficiaries and applicants (actual and potential) and is therefore not a nationally representative survey.

3.3 The chapter's main findings can be summarized as follows:

- Pakistan implements a variety of social protection programs ranging from safety net (e.g., cash transfer programs and school feeding programs) to social security programs (e.g., pensions). Some of these programs hold significant potential for alleviating poverty and managing household risks, and recent attempts to experiment with more creative program designs and to evaluate program impacts are commendable. However, important constraints in terms of resources, coverage, targeting and implementation need to be overcome for these programs to have a real impact on poverty and vulnerability.
- Aggregate social protection expenditures are low, spread too thin across too many programs, and biased toward social security. Moreover, expenditures have decreased (as a share of GDP) in recent years. The combination of these factors translates into insufficient program coverage given existing needs. For instance, 2 million households receive benefits from the two main cash transfer programs while the total number of households vulnerable to chronic poverty is close to 8 million. Finally,

approximately 80 percent of all resources allocated to social protection are devoted to social security, which tends to benefit the non-poor and those with access to formal employment.

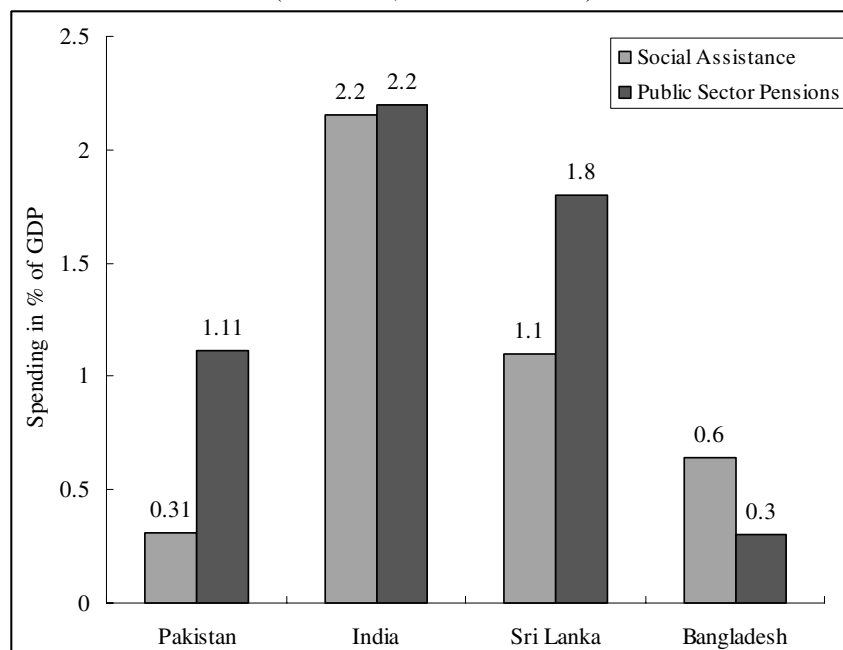
- The impact of safety net programs on poverty and inequality is almost negligible due to limited coverage and deficient targeting, small levels of benefits and irregular benefit payments.
- Most programs lack an objective targeting instrument. For instance, between 20-30 percent of total resources allocated to the two main safety net programs accrue to the poorest 20 percent of the population, compared to 17-18 percent for the richest 20 percent. These figures compare poorly to similar programs in other countries.
- Benefits are small. Cash transfers are equivalent to 10-15 percent of average household income among program beneficiaries, and actual annual payments frequently fall short of stipulated levels. Similarly, the average pension paid by private sector schemes is equal to 30 percent of the minimum wage. Aside from low coverage and benefits, safety net programs have limited exit strategies—beneficiaries are not systematically provided incentives to improve current or future earning opportunities (through access to microfinance or health and education programs), although some promising (albeit early) pilots have been initiated.
- The impact of social protection programs on vulnerability is also limited because programs focus either on the chronic poor or on non-poor formal sector workers. Safety net programs are biased toward income support for the chronic poor and are limited in their ability to expand in times of natural disasters or other aggregate shocks. The low coverage of programs means that poor and vulnerable households still have to deal with a significant amount of risk on their own, including that associated with idiosyncratic (health) and aggregate (economic shocks)—the most prevalent types of shocks and those which induce the highest losses on their own. Social security programs tend to provide insurance almost exclusively to the non-poor due to their strong links to formal employment.
- Finally, social protection programs, both safety nets and social security, suffer from poor quality of service, deficient information, weak program management and excessive fragmentation, all of which detract from program effectiveness

II. PAKISTAN'S SOCIAL PROTECTION SYSTEM: A BRIEF OVERVIEW

3.4 **Social protection expenditure levels are low and skewed toward social security.** The country spends about 1.4 percent of GDP on social protection (including civil service and military pensions), compared to 4.4 percent in India and 2.9 percent in Sri Lanka (Figure 3.1). Moreover approximately 75 percent of these resources are allocated to public and military sector pensions, compared to 51 percent in India and 62 percent in Sri Lanka.⁴² Even Bangladesh, which spends less than Pakistan on social protection (0.9% of GDP), devotes a significantly larger proportion of this budget to safety nets programs (0.6% of GDP) than to social security (0.3% of GDP). This bias in spending has important implications since social security tends to benefit the non-poor and those with access to the formal sector. Pakistan's low spending on safety nets reflects the historically low importance attached to social protection and to the human development sectors generally. The fact that Pakistan spends little resources on these programs may have certain advantages, however. Limited resources prevent programs from growing too fast or excessively in response to reasons not entirely related to their main objective (say, for political reasons), and may contribute to keep program bureaucracy under control. Rather it is the combination of scarce and poorly targeted resources and a large number of programs that significantly undermine the effectiveness of these resources.

⁴² Social assistance expenditures figures for Pakistan include pensions for private sectors workers, so that the actual safety net expenditure figure is below 0.5 percent of GDP (approximately 0.4 percent of GDP).

Figure 3.1: Spending on social protection in South Asia
(% of GDP, 2004/05 or latest)



Sources: World Bank Staff estimates from country safety net and social protection reports and a regional pension study.⁴³ Social assistance is for 2004/05 and includes spending on those programs that each country report has considered part of the safety net/social assistance (such as targeted programs, workfare, food subsidies) which can give rise to some variation in what is covered by these estimates. Public sector pensions are for the latest year available and refer to spending on civil service and military pensions. Estimates are not fully comparable across countries, for example due to differences in the way that military and private pensions are included. The figure for Pakistan shown here includes spending on military pensions for comparative purposes, whereas the discussion in the remainder of this report excludes military pensions.

3.5 In addition, social protection spending, as a share of total pro-poor spending, has declined significantly over time, primarily as a consequence of the reduction in the budget of three of the main safety net programs. This decline took place at a time of improved fiscal stance that was witness to increases in spending in other social sectors. Consolidated education expenditures increased from 1.5 percent of GDP in 2001/02 to 1.78 percent in 2004/05, and total pro-poor, or PRSP expenditures, increased from 3.8 percent of GDP in 2001/02 to around 5 percent in 2005/06 according to the government. As a consequence, the share of social protection expenditures in PSRP expenditures fell from 7.2 to 3.3 percent between 2001/02-2005/06.

3.6 Pakistan’s social protection system comprises a myriad of programs, ranging from cash transfer programs, to programs that supply textbooks to schools in poor areas, to pensions.

⁴³ Sources for social assistance are: Pakistan—this report; India—draft safety net study (forthcoming, 2007); Sri Lanka—“Strengthening Social Protection” (2007); Bangladesh—World Bank (2005c). Public pension spending estimates are from Palacios (2004) “Civil Service Pensions In South Asia: A Rising Tide Of Reform”.

Although generally conceived to alleviate poverty and fight vulnerability, these programs have different objectives, provide different types of benefits and target different groups of the population. The programs also vary widely in terms of their funding. The largest safety net programs are the Zakat, Bait-ul-Mal (both cash transfer programs), and the wheat subsidy. In 2003/04 these programs accounted for 0.10, 0.05, and 0.14 percent of GDP, respectively. Social security includes both public and private pensions. As mentioned above, civil service pensions account for 0.50 percent of GDP, while private pensions account for 0.10 percent (Table 3.1). Not included in this account are the subsidies on power, water, gas, and fertilizer (see Box 3.1).

Table 3.1: Spending and Beneficiaries of Main Social Protection Programs (2003/04)

	Expenditures (Rs. billion)	Share of GDP ^D (%)	Share of total SP budget (%)	Source of funding	Number of beneficiaries
SAFETY NETS					
Income support and basic services					
Zakat (guzara and other)	5.9	0.10	11.3	Private (Zakat levy)	1.6 mn ^A (guzara: 0.8 mn)
Bait-ul-Mal ^C	2.5	0.05	4.9	Federal budget	1.25 mn ^A
Social welfare services	0.5	0.009	1.0	Federal budget	N.A.
Exit Policies					
Human capital accumulation--Tawana	0.7	0.012	1.3	Federal budget	530,000 ^A
Coping with Aggregate Risks					
Wheat subsidy	8	0.14	15.4	Federal and provincial budgets	N.A.
TOTAL safety nets	17.6	0.31	33.9		
SOCIAL SECURITY					
Public sector					
Civil service pension schemes (excl. military pensions) ^E	28.0	0.50	53.8	Federal and provincial budgets	0.8 mn retirees / 1.96 mn active workers
Private sector					
Employees Old Age Benefits (EOBI)	1.7	0.030	3.3	Private sector employers	225,000 retirees / 2.3 mn members / appr. 1.5 mn contributors ^B
Workers Welfare Fund (WWF)	2.6	0.046	5.0	Private sector employers	N.A.
Employees' Social Security (ESSI)	2.1	0.037	4.0	Private sector employers	850,000 ^B
TOTAL social security	34.4	0.61	66.1		
TOTAL	52.0	0.92	100.0		

Sources: Issues and Policies Consultants (2004); World Bank (2006a); and information from program managers.

N.A. Not available

^A Number of beneficiaries of recurrent cash and non-cash benefits. ^B Number of workers covered by insurance scheme. ^C Budget of Bait-ul-Mal has since been increased to Rs. 4.5 billion (0.08% of GDP) and the number of beneficiaries of FSP, its largest program, to 1.45 mn. ^D Based on revised estimate of GDP (at current market prices) for 2003/04 of Rs. 5,641 mn. ^E Including military pensions would raise spending to Rs. 60 billion (1.07% of GDP), and beneficiaries to 1.9 mn retirees and 2.9 mn active workers. Total SP spending including military would then be around 1.4% of GDP.

3.7 The combination of low and declining expenditure levels and a large number of programs implies that resources are spread too thin, particularly in safety net programs. As a consequence, coverage is suboptimal, the benefits offered by these programs are often insufficient and their frequency is irregular. We discuss these issues in more detail below.

Box 3.1: Fiscal expenditures on price subsidies are substantial, but do not provide social protection

The federal government is planning to spend almost Rs. 90 billion on price subsidies in 2006/07, an increase of 75 percent since 2004/05 in nominal terms (Figure 3.2). These subsidies—71 percent higher than total social protection spending and five times larger than total social assistance spending—cover the losses of utilities in the electricity, gas, and water sectors, lower the costs of fertilizers to farmers, and attempt to lower and stabilize the cost of basic food items. The bulk of the subsidy budget (82%) is spent covering the losses of WAPDA and KESC (Figure 3.3). This expenditure is as an attempt to provide energy and water to consumers (often urban and middle class) below cost. Most of these subsidies do not form part of a social protection ‘system’ as they do not target the poor, or mitigate against risk. Wheat subsidies are the exception, as they are aimed at consumer food security through wheat price risk management

Figure 3.2: Federal Government Subsidies, 2004/05-2006/07 (Rs. Million)

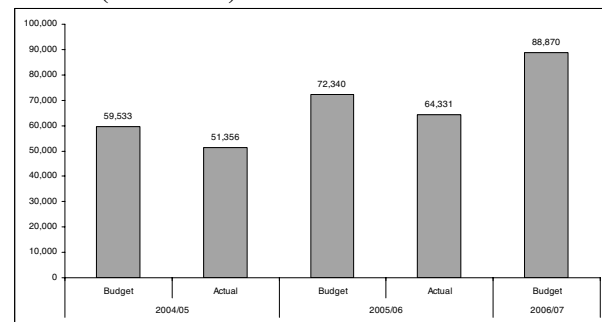
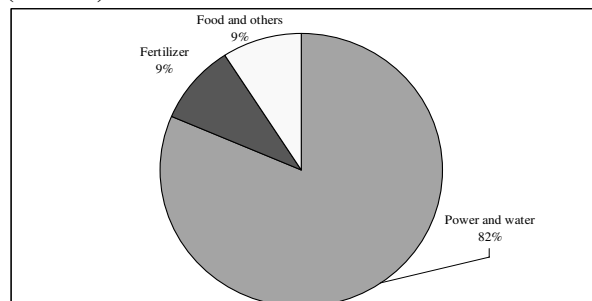


Figure 3.3: Most subsidies are for power and water (2005/06)



Source: Based on federal government budget figures

III. SAFETY NETS: PROVIDING INCOME AND SERVICE SUPPORT FOR THE POOR

3.8 The main causes of high chronic poverty and vulnerability are low endowments of physical and human capital and limited access to basic services and markets, which in turn translate into low levels of consumption. For this reason the main objective of targeted safety net programs is to provide minimum income support or access to basic social services to the poor, particularly the most vulnerable within this group—normally children, the disabled and the elderly. Not all programs are designed to react quickly to the occurrence of shocks by, for instance, contracting and expanding, so that their overall impact on vulnerability is limited.

A. Cash Transfers (Income Support) and Basic Services

3.9 Cash transfers to the poor and the provision of basic services for vulnerable groups (disabled, child labor, vulnerable women) are the main safety net programs in Pakistan. This section outlines the main issues facing the delivery of both of these services to the poor.

1. Cash Transfers

3.10 **In Pakistan income support is provided through two cash transfer programs, Zakat and Bait-ul-Mal.** Although similar in terms of their overall objective and target population, these programs have different histories, and are operated and funded in substantially different ways. Zakat is the Islamic term for charity and one of five pillars of Islam. The program, which is entirely based on private contributions, was initiated by President Zia ul-Haq in 1980. Interestingly, although the idea of private charity is clearly not exclusive to Pakistan, the fact that such a charity is administered by the government is uncommon (see Box 3.2 for a discussion of similar programs in other countries). In contrast, Bait-ul-Mal (PBM), which was introduced in the early 1990s as a replacement for an existing food program, is both funded and administered by the government.

Box 3.2: Zakat in other countries

Zakat, or charity to the poor, is one of the pillars of Islam. Private, voluntary Zakat giving is an important part of the informal safety net in many Islamic countries. A study in Yemen, for example, found that overall Zakat transfers are quite well targeted to the poor. However, there is a heavy urban bias: 27 percent of urban households receive Zakat against 8 percent in rural areas. There is also a heavy concentration of giving at the timing of Ramadan.

Only few countries have chosen to make Zakat part of their formal safety net system, among them Malaysia, Saudi Arabia, and the Sudan. Sudan's Zakat Fund was established by law in the early 1980s with a setup that closely resembles Pakistan's Zakat. It is a religious-based system of wealth redistribution founded on the moral responsibility of the rich toward the poor. Every Muslim whose wealth exceeds a certain level is obliged to give every year a fixed ratio of his accumulated wealth for the benefit of poor people. In 1984, the Zakat Act was passed and the fund was brought under the taxation department. In 1986, a Chamber was established to manage all Zakat operations, and in 1990 a new Act for Zakat was passed making the payment of Zakat mandatory for all wealthy persons and corporate bodies. The Chamber, which is independent of all other tax-raising agencies, is supervised by a board of trustees appointed by the President. It is audited by the Auditor General. States' chambers and thousands of local committees at the level of villages and urban areas collect Zakat. Funds are disbursed to various categories of poor people. Sudan has been quite successful at raising revenues. Zakat resources have increased steadily over the years, and in 2001 US\$51 million was collected, equivalent to 0.6 percent of GDP. The overall impact of the program remains to be evaluated.

Sources: World Bank (2003a and 2003b).

3.11 A detailed description of both programs is provided below combining administrative data and other information with new results from a special module of the PSNS developed for the purpose of this report. Conditional on data availability, the discussion focuses on the following issues: program objectives and benefits, institutional structure, financing, coverage and targeting, adequacy and impact of benefits, and quality of service provided by the program.

Zakat

3.12 **Zakat seeks to provide income and other support to the ‘Mustahiqeen’ (deserving needy) among the Muslims.** Support under the program takes various forms, the most important of which are the subsistence (guzara) allowance and the rehabilitation grants for the establishment of small businesses. The guzara allowance is a recurrent monthly transfer of Rs. 500 per household, while rehabilitation grants are one-time payments that can range from Rs. 10,000 to Rs. 30,000 per household. The program also provides education and health-related benefits to selected groups of beneficiaries (Table 3.2).

3.13 **Guzara accounts for the largest share of beneficiaries, while rehabilitation grants account for the largest share of program resources** (Table 3.2). More than 800,000 households received income transfers from guzara, for an average annual value of Rs. 2,364. An additional 30 percent of households received education and health benefits, either in cash or in kind (see Box 3.3), while 10 percent received rehabilitation grants. Because these grants are significant, however, they account for 40 percent of all Zakat’s resources, followed by guzara, which distributes 30 percent of resources. All other programs under Zakat account for less than 10 percent of total resources each.

3.14 **Recent changes in the number of beneficiaries and the amount and distribution of resources have shifted the focus of the program, concentrating it on guzara and, particularly, the rehabilitation grants.** The number of Zakat beneficiaries has declined slightly over time, from 1.7 million in 2002/02 to 1.6 million in 2003/04, due mostly to a reduction in the number of households receiving educational stipends that was not fully compensated by the increase in the numbers of rehabilitation grants recipients (Table 3.2). The amount of resources distributed by the program stagnated in real terms during the same period.⁴⁴ Because the growth in rehabilitation grants actually surpassed that of overall program resources (see discussion below), this change translated into a shift in program focus toward one-time grants despite the official rule that stipulates that at least 60 percent of program resources should be allocated to guzara.

Box 3.3: Zakat for health care

Around 3 percent of Zakat disbursements are used to finance healthcare. Under the program, the eligibility of a person is determined by the Local Zakat Committee of his permanent residence. However, in the event of an emergency, the Central Zakat Council is empowered to assess the eligibility of a patient. Presently, 80 national level hospitals/institutions are registered with the Central Zakat Council for eligibility to Zakat funds at the rate of Rs. 2,000 and 1,000 for in- and out-patient care, respectively. For treatments requiring larger sums of money, the Health Welfare Committees constituted in the eligible hospitals and headed by the Medical Superintendent of the hospital, are empowered to approve the medical treatment.

⁴⁴ Zakat expenditures grew in nominal terms from Rs. 5583 million in 2001/02 to Rs. 5861 in 2003/04, which represents stagnation in real terms.

Table 3.2: Overview of Zakat programs (2003/04)

	(1)	(2)	(3)	(4)	(5)	(6)
	Budget (Rs. mn)	Expenditures (Rs. mn)	Total No. beneficiaries	Average annual benefit	Share of expenditures (%)	Share of beneficiaries (%)
A. REGULAR PROGRAMS						
Guzara Allowance	2,168	1,923	813,642	2,364	33	51
Educational stipends	650	409	289,181	1,414	7	18
Stipends to Students of Deeni Madaris	289	174	69,851	2,495	3	4
Health Care	217	152	186,750	815	3	12
Social Welfare/Rehabilitation	145	121	25,544	4,740	2	2
Marriage Assistance to Unmarried Women	145	122	11,876	10,306	2	1
Sub-total (A)	3,613	2,902	1,396,844	2,077	50	88
B. OTHER PROGRAMS						
Eid Grant	210	209	0		4	0
Leprosy Patients	1	0	56	8,214	0	0
Permanent Rehabilitation Scheme, Phase III	5,000	2,320	175,664	1,302	40	11
Educational Stipends (Technical)	1,000	429	22,310	19,240	7	1
Sub-Total (B)	6,211	2,958	198,030	14,938	50	12
Grand Total (A+B)	9,824	5,861	1,594,874	3,687	100	100
Total as share of GDP	0.17%	0.10%				

Source: Issues and Policies Consultants (2004) based on information from program administrators. Expenditures are in some cases lower than budget because of delays in disbursement.

Institutional arrangements

3.15 **The government (through the federal Ministry of Religious Affairs and the provincial Zakat and Social Welfare Departments) supervises and regulates the program** subject to the guidance by the Zakat Council, headed by a Supreme Court judge. Provincial Zakat committees are headed by a Provincial High Court judge. A system of voluntary Zakat committees at the local, district, and provincial levels implement the program and disburse the funds. There are almost 40,000 local Zakat committees in the country, staffed by some 400,000 unpaid volunteers, aided by a small support staff of clerks. Administrative costs are therefore very low (around 3 percent). However, there is no management information system and the system relies on paper records. Each Zakat committee is supposed to have nine members, of which two are women, and is meant to cover approximately 3,000 people. As a result it is common for larger villages to have multiple Zakat committees and for several small villages to be grouped under a single committee. Benefits are paid out through banks.

3.16 **The system, however, is not free of flaws.** Zakat committee members are supposed to be elected by villagers and to be apolitical, but field evidence indicates otherwise. As a consequence, implementation at the local level is often unsupervised and patronage is common (Box 3.4). In an attempt to correct this problem all local Zakat committees were dissolved in 2001 through a Presidential Order on charges of politicization and financial mismanagement of the system, and around 40,000 new Zakat committees were constituted. Unfortunately there is no systematic evidence on the impact of this measure, apart from the safety net survey which suggests that many issues remain unresolved (see below). In 2003, the Federal Cabinet appointed a Cabinet Committee to review these issues. Its report was submitted in November 2006 and is under consideration by the Cabinet.

Box 3.4: Corruption and patronage in Zakat

Based on field work in Sindh and Punjab, Kabeer, Mumtaz, and Sayeed (2006) report evidence of both corruption and patronage in the Zakat distribution system. People also perceived an apparent randomness and confusion in the eligibility decisions. Often, provision seems based on access to influential patrons or willingness to pay a bribe. They came across an area where multiple members of a single *biraderi* received Zakat while members of other, equally poor *biraderis* were completely bypassed. They also found evidence of petty bribes in getting access to the Bait-ul-Mal office, and in getting a government identity card.

Writing about NWFP, Schlichting (2005) says that “Of all the people consulted for this report, the majority believed the current system of Zakat to be inefficient and ineffective... These criticisms are levelled at the current implementation of Zakat, and not the principle of Zakat. A commonly voiced frustration was over the large gap between the Zakat principle and its execution. The process of funds distribution is held to be highly politicised, and eligibility and selection for the program are both subjective...In one village in Swat, for example, people said that Zakat is a system to which the poor do not have access. A small group of landlords administers Zakat, and controls the selection process. They put only their own tenants and labourers on the Zakat list, and Zakat funds are then assigned to these people. However, because the tenants and labourers are in debt to the landlord, they are obliged to give the Zakat money directly back to their landlord.”

Financing

3.17 **Zakat has a unique financing mechanism.** The program does not receive public funding, but rather is financed through a special levy of 2.5 percent of the value of private financial assets (savings accounts and fixed financial assets, over a fixed threshold⁴⁵). This levy is deducted at source at the beginning of the month of Ramadan and paid into a central fund administered by the autonomous Zakat Council and maintained by the State Bank of Pakistan.⁴⁶ A part of the collected funds is disbursed to national institutions, such as hospitals, for providing free health care to the poor. The rest is forwarded to provincial Zakat councils for further distribution to district Zakat councils for ultimate delivery by local Zakat councils to the deserving poor. Zakat funds are allocated to provinces and districts on basis of population, while allocation within districts is based on needs, as perceived by the district committee, and no formal system exists to determine the intra-district allocation. Lack of geographic targeting is a major drawback, as discussed below.

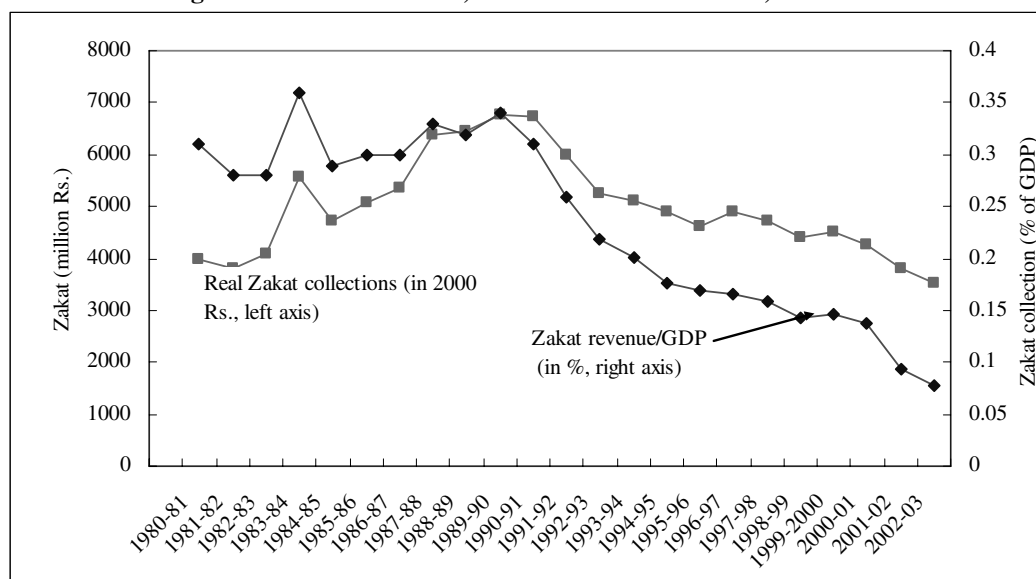
3.18 **The program’s financial sustainability, however, is in question due to the decline in Zakat levy collections and the gradual depletion of program reserves.** Contributions to Zakat declined from 0.3 percent of GDP in the 1980s to 0.08 percent in 2002/03 (Figure 3.4). This decline can be attributed to a change in the regulation of the levy, which made payments voluntary after 1999 and allowed those with

⁴⁵ Only people who own assets the aggregate value of which is greater than 612.32 grams of silver are liable for Zakat, although there are several exceptions such as foreign denominated assets.

⁴⁶ Ushr is a separate levy raised on the value of agricultural produce from large farmers; only very modest amounts of funding are raised in this manner.

a negative perception of the program (a majority) to stop contributions. Prior to 1999, all Muslim Pakistanis were obliged to pay Zakat, except those who filed a declaration that their ‘Fiqah’ (sect) does not permit payment of Zakat to the State, although loopholes made it relatively easy to evade the Zakat levy, for example by withdrawing funds from the financial system just prior to Ramadan. However, a 1999 judgment of the Supreme Court made payment of Zakat voluntary for all. It allows all sects to file a declaration seeking exemption from paying Zakat on financial assets. Steps taken by program administrators to improve public opinion have so far proven insufficient to reverse the drop in funding. This problem is compounded by the gradual depletion of program reserves that has taken place in recent years (Figure 3.4). The accumulation of Rs. 15.0 billion in reserves between 1980 and 2003 prompted the government and the Central Zakat Council to introduce a new benefit, the Permanent Rehabilitation Scheme (rehabilitation grants), aimed at increasing access to economic opportunities among recipient households through the promotion of small businesses. In three years the program has distributed Rs. 5 billion in grants, bringing reserves down to Rs. 10 billion. Once the accumulated reserves have been exhausted, which is set to happen around 2008, it will not be possible to sustain the current level of disbursements if declining levy collections remain the only funding source, which raises the question of the program’s long-term sustainability.

Figure 3.4: Zakat revenue, in real and relative terms, 1980-2003



Source: Derived from information provided by Issues and Policies Consultants (2004) and by program administrators.

Coverage

3.19 Zakat’s coverage is very limited compared to Pakistan’s needs, stemming in part from a low budget. According to survey data,⁴⁷ only 3 percent of all households receive benefits, mostly under the guzara (2.2 percent) and rehabilitation grants (0.4 percent) modalities (administrative data show higher coverage). Coverage is slightly higher in rural than in urban areas. Similarly coverage is highest in NWFP (5 percent of all households), followed by Balochistan (3.9 percent), Punjab (1.4 percent) and Sindh (1.3 percent). These numbers fall abysmally short of the country’s needs measured in terms of poverty and vulnerability incidence. In fact only 50 percent of those who felt they needed assistance applied for it and

⁴⁷ This is based on PSNS Phase I which is nationally representative and has a sample size of 30,005 (see Appendix 1).

only 22 percent of all program applicants received any benefit. Many of the rejected applicants were among the poor. The main reasons given for seeking assistance were widowhood, disability, health shocks and family-related shocks (e.g., daughter's marriage), while those not applying for assistance did not do so because their expectations of receiving any were low. Low coverage results in part from limited resources. Zakat's budget is equivalent to 0.13 percent of GDP and has been declining over time. Coverage levels are also low when compared to those of other countries. For instance, 20 percent of the population received government cash transfers in Vietnam in 1997 (Prescott, 1997) and more recently Oportunidades in Mexico paid transfers to 20 percent of the population.

Targeting

3.20 **The targeting of Zakat has some pro-poor elements but could perform better.** According to PSNS Phase II, around 27 percent of guzara beneficiaries and 37 percent of those receiving rehabilitation grants are not poor, accounting for 32 and 45 percent of the resources distributed under each modality (Table 3.3). Comparisons of (pre-program) average consumption levels among beneficiary and non-beneficiary households tell a similar story. Average expenditure levels among guzara beneficiaries are 11 percent higher than those of non-recipient households, while no significant differences exist among those in the rehabilitation grant program. Comparing to other countries, the targeting performance of Zakat is worse than poverty-targeted conditional programs in Bangladesh, Mexico, and Central America (see Table 3.4 based on expenditure quintiles from PSNS Phase I).⁴⁸ In Honduras, some 80 percent of conditional cash transfers reach the bottom 40 percent, in Mexico it is 62 percent, and in Bangladesh around 48 percent of Food for Education resources go to the bottom 40 percent. In Pakistan, Bait-ul-Mal delivers around 46 percent of its benefits to the poorest 40 percent of the population, while Zakat overall has around 43 percent of resources flowing to the bottom 40 percent of the population (for guzara, the figure is 33 percent; for rehabilitation, 47 percent; and for other Zakat such as stipends, 55 percent).

Table 3.3: Distribution of benefits and beneficiaries

	Ultra-poor		Poor		Non-poor		Total
	% of beneficiary households	% of program funds	% of beneficiary households	% of program funds	% of beneficiary households	% of program funds	
Guzara	39	33	33	35	27	32	100
Rehabilitation	44	23	19	32	37	45	100
Bait-ul-Mal	46	45	30	32	23	23	100
All sample households	38		35		27		100

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (representative of safety net recipients/applicants).

Note: Before forming the income groups, expenditures have been adjusted to counterfactual pre-program levels by subtracting half of the average monthly program receipt over the last 12 months from the total expenditure.

3.21 The question then arises as to what factors may explain the mixed targeting record of Zakat, both in terms of beneficiary selection and benefit allocation. We consider three such factors below: (i) lack of an objective targeting tool, (ii) selective program access, and (iii) biased benefit level determination.

⁴⁸ Phase I, which was nationally representative, did not contain a consumption module, so the quintiles here are based on short, self-reported adult equivalent expenditures which have been adjusted to reflect pre-program levels by subtracting half of benefits. There is one exception, rehabilitation grant, where quintiles have not been adjusted for benefits, because these benefits represent one-off investment grants rather than consumption support.

Table 3.4: Targeting performance of cash transfers in Pakistan and internationally
(Cumulative share of benefits, by quintile, in percent)

Quintile	Zakat			All Zakat	Bait-ul-Mal	PRAF (Honduras)	PROGRESA (Mexico) ^{b/}	Food for Education (Bangladesh)
	Guzara	Rehabilitation	Other Zakat ^{a/}					
Lowest	16	16	42	21	29	43	40	-
2	33	47	55	43	46	80	62	48
3	52	73	77	64	67	94	81	-
4	71	89	91	82	83	98	93	-
Highest	100	100	100	100	100	100	100	100

Sources: Pakistan data are staff estimates based on data from Phase I of Pakistan Safety Net Survey, which was nationally representative, and quintiles are based on short, self-reported adult equivalent expenditures adjusted to reflect pre-program levels. International data are from World Bank (2005j). See also Coady, Grosh, and Hoddinott, 2004. Notes: *a/* Other Zakat include stipends, marriage grants, etc. *b/* PROGRESA is now called Oportunidades.

3.22 **Broadly speaking, Zakat aims to target the ‘deserving needy’, but no objective targeting tool is used.** The ‘deserving needy’ are understood to include widows, orphans, the disabled and others living in genuine poverty, but no operational definition of poverty or targeting mechanism exist, leaving eligibility decisions in the hands of the chairmen and members of the local Zakat committees. Although allowing for subjective judgment can help officials reach decisions that take into account a variety of circumstances not captured by a pre-set formula, these decisions are often based on subjective judgment and can be easily twisted for patronage and political purposes or even exploited by corrupt individuals. In fact econometric analysis of the determinants of beneficiary selection shows that, although selection does depend positively on some pro-poor factors (e.g., female-headed household, illiterate household head, presence of elderly, etc.), others appear to have no explanatory power (e.g., mud house, large household size, high dependency ratio, amount of cultivated land), corroborating the idea that selection decisions do to a large extent respond to the discretion of the Zakat committee, which sometimes leads to inclusion errors.⁴⁹ As a result, while both the need for assistance and program applications are more common among the poorest, selection rates are only modestly higher among low income quintiles. Moreover, most of the rejected applicants belong to the lowest quintiles—there are large exclusion errors. In fact, the rejected applicants tend to be poorer than the accepted applicants (Table 3.5).

Table 3.5: Distribution of PSNS Phase I sample by program status and quintile
(in column %)

Quintile	Beneficiary of cash transfer	Applied, did not receive	Felt the need but did not apply	Did not feel the need	All households
1	21.3	36.8	28.8	16.1	20.1
2	19.6	23.2	23.1	19.0	20.0
3	20.5	18.1	19.7	20.4	20.0
4	16.3	12.4	15.9	21.8	19.9
5	22.3	9.5	12.6	22.7	20.0
<i>Total</i>	100.0	100.0	100.0	100.0	100.0

Source: staff estimates based on data from Phase I of Pakistan Safety Net Survey, which was nationally representative; quintiles are based on short, self-reported adult equivalent expenditures adjusted to reflect pre-program levels.

3.23 In addition, **although Zakat has extensive field presence, program offices tend to be located in relatively better off localities.** Approximately 88 percent of all localities covered by the PSNS had a

⁴⁹ See Appendix 3 for a detailed discussion of the econometric analysis.

Zakat committee and in 80 percent of these the committee was active and met on a regular basis. Sindh constituted the main exception to this overall pattern, with committees in only 75 percent of localities, and functioning committees in only 55 percent. Communities with active Zakat committees, however, appear to have higher (pre-program) income per capita than those without. This difference was more marked in rural areas and among communities with beneficiaries of the rehabilitation grant program. This is confirmed by multivariate analysis of program placement, which shows that Zakat is more likely to cover locations with relatively more developed village infrastructure and where other development programs exist⁵⁰ (Table 3.6). As a result, it becomes difficult or impossible for those living in the poorest, and often most remote communities, to access Zakat.

Table 3.6: Average household income according to program presence
(Rs. per month)

	Guzara		Rehabilitation		Bait-ul-Mal	
	No presence	Present	No presence	Present	No presence	Presence
Rural	5,314	6,074	5,659	6,214	5,762	5,725
Urban	7,984	7,054	7,453	8,447	7,796	6,934
Total	6,450	6,381	6,343	6,823	6,495	6,413

Source: Staff estimates based on data from Phase I of Pakistan Safety Net Survey (nationally representative, but based on brief self-reported incomes).

3.24 Finally, benefit levels under Zakat appear to increase in absolute value with household income and other measures of welfare. Average benefit payments paid by guzara are 5 to 10 percent higher among the non-poor than among the poor or the ultra poor (both for the last installment and when all payments over a 12-month period are taken into account). Again the non-poor bias is more marked in rural than in urban areas. As before, regression results tend to confirm that differences do exist, even after controlling for other factors—i.e., conditional on receiving benefits, amounts paid by the programs are positively correlated with factors associated with lower levels of poverty and vulnerability, such as low dependency ratios, ownership of arable land, ownership of dwelling and other assets (e.g., television).

3.25 In sum, discretion in program selection, combined with biases in program location and benefit allocation that result in relatively better access and higher levels of benefits for the non-poor, explain why Zakat exhibits targeting outcomes that are below those observed for similar programs both inside and outside Pakistan (see discussion below on targeting of Bait-ul-Mal).

Adequacy and impact of benefits

3.26 Zakat’s (guzara) benefits have a limited impact on poverty and income distribution. Guzara transfers and rehabilitation grants represent 14 and 23 percent of average recipient household income, respectively (Table 3.7). These figures are higher among ultra poor households (25 and 42 percent) and lower among poor and non-poor households (around 6 to 8 percent for each program modality). In comparison conditional cash transfer programs in Mexico and Nicaragua provide approximately 21 percent of average household expenditures. Given the relatively small size of program benefits, it is not surprising for poverty and inequality to decline only slightly as a consequence of these transfers.⁵¹

⁵⁰ Ibid.

⁵¹ Inequality in household expenditures, measured by the Gini coefficient, declines by 2.5 percent from 0.326 to 0.318 once public cash transfers are taken into account (similar to the impact of private transfers on inequality). In addition, given that benefits account for a larger portion of household income among poorer households, it is likely that program impact on poverty is larger when using poverty indicators that weight extreme poverty more heavily, such as the poverty gap and the severity of poverty. Unfortunately these calculations are not available.

Although the fact that transfers represent a reasonably high share of household income among the ultra-poor could suggest that they can potentially create disincentives for program exit, it is important to keep in mind that (i) consumption levels are extremely low for these households (i.e., less than one third of the poverty line) and that (ii) poor household characteristics and endowments make this group relatively more unlikely to benefit from initiatives that support sustainable poverty exit strategies.

Table 3.7: Adequacy of program benefits
(benefits received 12 months prior to survey)

	Average annual benefit received (Rs), conditional on receiving	Benefit in % of household consumption	Benefit in % poverty line (Rs. 937 per month per person) for a family of six	Benefit as % of average agricultural wage
Zakat guzara				
Ultra-poor	3235	25	4.79	12.0
Poor	2602	8	3.85	9.6
Non-poor	2762	6	4.09	10.2
Total	2892	14	4.28	10.7
Zakat Rehabilitation				
Ultra-poor	5435	42	8.05	20.1
Poor	2277	7	3.37	8.4
Non-poor	3683	8	5.46	13.6
Total	4751	23	7.04	17.6
Bait-ul-Mal				
Ultra-poor	1886	11	2.79	7.0
Poor	2318	8	3.43	8.6
Non-poor	1545	5	2.29	5.7
Total	1949	9	2.89	7.2

Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey, (representative of safety net recipients and applicants).

3.27 Low poverty and inequality impact can be attributed to low benefit levels, and particularly to irregularities in benefit payments. It is common for beneficiary households to receive less than the stipulated benefit from Zakat. The total amount received by the average household from guzara during the last 12 months prior to the survey was Rs. 2,892, equivalent to 5-6 monthly payments of Rs. 500, compared to a full entitlement of Rs. 6,000 (or 12 monthly payments of Rs. 500). The main reason behind underpayment is the widespread custom of local Zakat committees to ‘make the Zakat money go further’ by paying smaller amounts to a larger number of households than what the stipulated rules and their available budgets would otherwise allow. Although each Zakat committee is supposed and budgeted to distribute guzara allowance to a fixed number of beneficiaries (often ten), many local Zakat committees choose to stretch their funds to cover double or triple the number of beneficiaries through fast entry and exit or decreasing payment frequency among beneficiaries (i.e., payment rotation).⁵² In this context a recent recommendation by the Ministry of Religious Affairs to increase guzara monthly allowances from Rs. 500 to Rs. 700 may fail to produce the expected results.

3.28 Evidence on the impact of Zakat’s second most important component, the rehabilitation grants, is limited but positive. Results from a beneficiary survey by Gallup show that most beneficiaries had indeed used the grant to open a shop or a small business, and that almost three out of four of these

⁵² Zakat has no official graduation or recertification policy for ceasing benefits; in practice, local Zakat committee chairmen use their judgment. Moreover, the report of the Auditor General Pakistan for 1995-98 maintains that, in a large number of cases, prescribed rules were not followed, and required standards of financial discipline were not observed (Issues and Policies Consultants, 2004).

shops and businesses remained viable at the time of the survey. Moreover, the data appears to suggest that 75 percent of these businesses would not have come into existence had the money not been granted. Caution is needed in interpreting these results, however, since alternative programs and initiatives in support of small businesses exist such as microfinance and the like.

3.29 Finally, in its current design, Zakat does not seem to have a positive impact on schooling.⁵³

Children in beneficiary households exhibit lower school enrolment rates than their counterparts, even in the same quintile (after income differences are taken into account). Although this could be explained by the low level of benefits relative to household income, international evidence suggests that tying benefits to school attendance, as increasingly done all over the world and also in the new Child Support Pilot (see Box 3.12), could improve human capital outcomes for the poor.

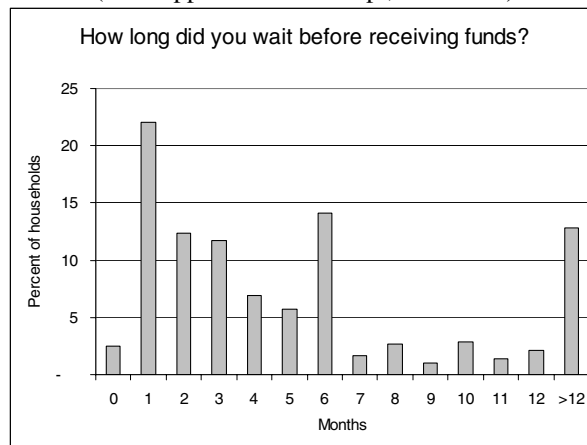
3.30 In sum, Zakat's potential poverty and inequality impact is undermined by the fact that benefits are small relative to household income, and paid irregularly. These outcomes result from the combination of the decline in program resources and the relative shift in program focus toward one-time benefits, such as the rehabilitation grants. Although these grants could hold promise in terms of improving access to economic opportunities among the poor, a careful evaluation is needed regarding the impact that their growth is having on Zakat's coverage and overall capacity to alleviate chronic poverty. In fact modest, frequent, reliable, long-term cash transfers may be a better option to achieve this goal (DFID, 2005).

Quality of service and beneficiary satisfaction

3.31 The most common complaints about Zakat's service concern the response time for payment activation after program registration, the cost associated with cashing program benefits, and the irregularity and lumpiness of benefit payments. The time elapsed from the submission of an application to Zakat's to the moment the first payment becomes effective varies significantly. While 25 percent of all applicants received their first payment within a month of application, 15 percent had to wait 6 months and an additional 13 percent declared to have waited more than a year (Figure 3.5). In addition the cost of obtaining benefit payments is high both in terms of time and cash. One in ten households had difficulty accessing the funds after being approved for assistance. Zakat beneficiaries on average needed to make 1.8 visits to the payment center to obtain their assistance and more than one in six had to go three times or more. To this we need to add that one of every twelve beneficiaries declared to have paid a bribe to obtain their benefits at some point, with bribes averaging 10 percent of the transfer. Bribes were most often paid to the local Zakat chairman. Finally, beneficiaries complain about installments being infrequent and lumpy. Although payments are supposed to be made monthly, the average beneficiary waited 8.6 months between *guzara* payments, with waiting times being higher in urban areas (Figure 3.6), and often received several installments at the same time. Unfortunately payment infrequency and lumpiness, which can be attributed to delays in the release of funds at the central, province and district levels, seriously undermine beneficiaries' capacity to use payments to effectively smooth consumption over time.

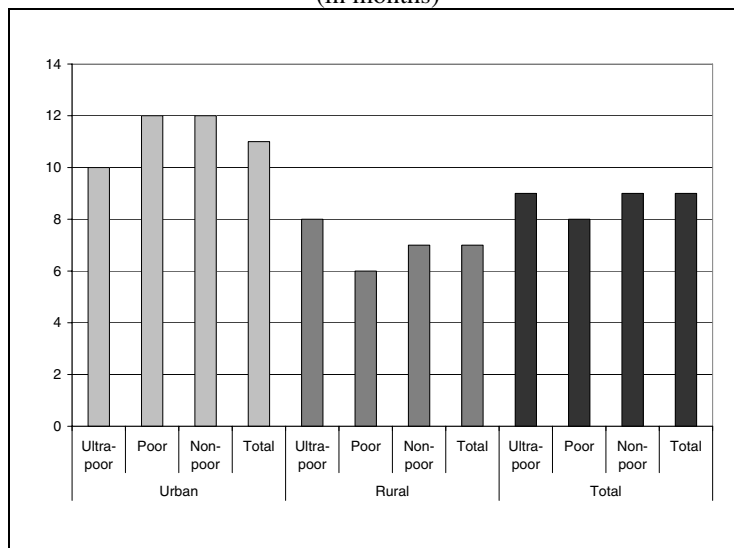
⁵³ It is also possible for cash transfers to have a negative impact on labor supply due the income effect generated by the transfer. This could be further aggravated in the presence of special conditions for benefit reciprocity, such as lack of employment. Although we have no information on the relationship between benefit reciprocity and labor supply, the absence of work-related conditions in the case of Zakat no doubt mitigates potentially negative effects.

Figure 3.5: Waiting time for obtaining Zakat
(from application to receipt, in months)



Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey (representative of safety net recipients /applicants)

Figure 3.6: Average waiting time between guzara payments
(in months)



Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey, which is representative of beneficiaries all over the country

3.32 **Although a majority of beneficiaries expressed dissatisfaction with some aspects of Zakat, they still viewed the assistance provided by the program as positive.** One in four beneficiaries said that benefit amounts were too low and infrequent, while fifty-five percent complained that funds were not given to deserving people but rather were allocated at the discretion of the local Zakat committee. In addition, some beneficiaries declared to have been victims of stigma (21 percent) or jealousy (16 percent) as a result of their affiliation with the program. Despite all of this, however, almost three quarters of Zakat beneficiaries believed assistance provided by the program to be helpful.

Table 3.8: Pakistan Bait-ul-Mal expenditures, by subprogram

	2001/02		2002/03		2003/04	
	Rs. (mn)	%	Rs. (mn)	%	Rs. (mn)	%
Food support program (FSP)	1834.5	85.6	1046.0	72.6	2062.9	81.1
Individual Financial Assistance (IFA)	35.3	1.6	149.2	10.4	228.6	9.0
Miscellaneous projects	41.5	1.9	70.3	4.9	94.1	3.7
Prime Minister's Kidney Centre	150.0	7.0	50.0	3.5	-	-
Bugti tribes	16.2	0.8	18.5	1.3	5.7	0.2
Institutional rehabilitation (NGOs)	12.1	0.6	20.2	1.4	40.5	1.6
Larkana housing scheme	5.0	0.2	0.1	0.0	2.3	0.1
Administrative expenses	48.2	2.2	85.9	6.0	110.7	4.3
<i>Total</i>	<i>2142.8</i>	<i>100.0</i>	<i>1440.2</i>	<i>100.0</i>	<i>2544.9</i>	<i>100.0</i>
<i>Total as % of GDP</i>	<i>0.072</i>		<i>0.060</i>		<i>0.057</i>	

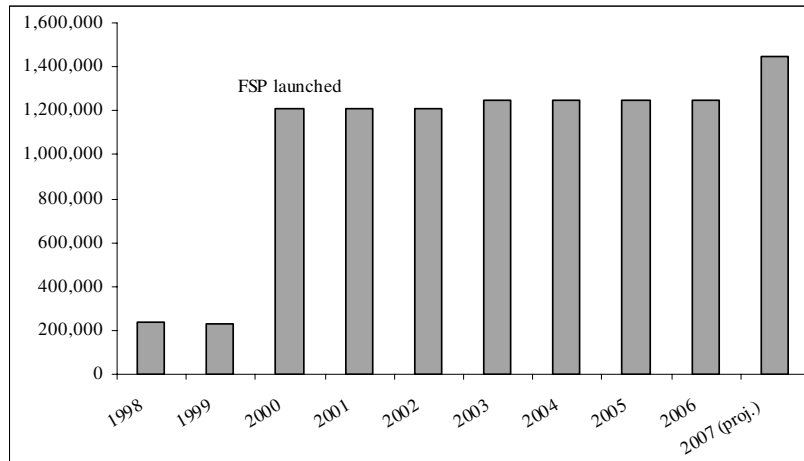
Source: Issues and Policies Consultants (2004) and program administrators.

3.33 **The Food Subsidy Program (FSP) constitutes the core of Pakistan Bait-ul-Mal (PBM), although the Individual Financial Assistance (IFA) has grown significantly in recent years.** The FSP accounts for 75-80 percent of total PBM resources and most of PBM beneficiaries. It was launched in 2000 with the objective of replacing a series of existing programs aimed at compensating the poor for rising wheat prices.⁵⁵ Since its creation the FSP has provided cash transfers to 1.2-1.25 million households, a number which has recently been increased to 1.46 million (Figure 3.7). The IFA is the second largest initiative under the PBM. It currently accounts for 10 percent of all programs resources, up from 1.5 percent in 2002/02. Assistance is supposedly restricted to needy individuals with no other means of income support, and is given on a first-come, first-serve-basis to approximately 30,000 households a year. Assistance can be granted under the following circumstances: reimbursement of medical expenses in government hospitals (up to a maximum of Rs. 300,000), reimbursement of education expenses for higher studies, support to creation of own business (up to Rs. 40,000), and other emergencies (up to Rs. 30,000).

⁵⁴ Of the 2,548 households covered in Phase II of the survey, 177 households received assistance from PBM, and these results are based on those beneficiaries as well as on findings from the community questionnaire, administered to key informants in all 300 sample sites.

⁵⁵ The Federal Government had initially launched a Food Stamp Scheme in 1992 for in-kind food subsidies, which was discontinued owing to poor implementation. A re-designed Food Subsidy Scheme was initiated in 1994, which was renamed the Atta Subsidy Scheme in July 1997 aimed at providing a cash grant of Rs. 200 per month per family to 520,000 poor households across Pakistan. To qualify for the scheme, household income had to be less than or equal to only Rs. 1,500 per month. The number of beneficiaries and the amounts disbursed were well below the targets. The scheme was withdrawn in 1999, and FSP was then launched.

Figure 3.7: Number of Bait-ul-Mal beneficiaries, 1997/98-2006/07



Source: Issues and Policies Consultants (2004) based on PBM documents.

Institutional structure

3.34 Program support is delivered through the PBM provincial and district branches, which run independently of both the Zakat structure and the provincial and district social welfare systems. Applications are submitted at the district level and are processed by the District Food Support Steering Committees with assistance from PBM’s district office. Although district offices of PBM verify the information submitted by applicant through selective home visits, decisions about eligibility are made by the District Food Support Steering Committees headed by the District Nazims and remain essentially administrative judgments. Benefits have up to now been paid out through Post offices, but a technical review is underway to assess the most effective disbursement channel (Post offices or banks).

3.35 PBM’s administrative costs are low and its management information system, though not without flaws, is significantly more developed than that of Zakat. Overall administration costs represent 4 percent of total resources (2 percent for FSP). This is relatively low compared to other cash transfer programs, which often run administrative bills in the order of 5 to 10 percent of total resources. In addition basic information on program beneficiaries is stored in a database accessible to program administrators—a significant advantage over similar programs, such as Zakat. Although this database is of limited use in its current format, a few improvements could transform it into an effective tool for monitoring the program in the future. For example, information could be collected on applicants who are not selected, and more could be done to systematically record key characteristics of all beneficiaries in a similar format. An agreement has been signed with NADRA for development of a new monitoring and information system.

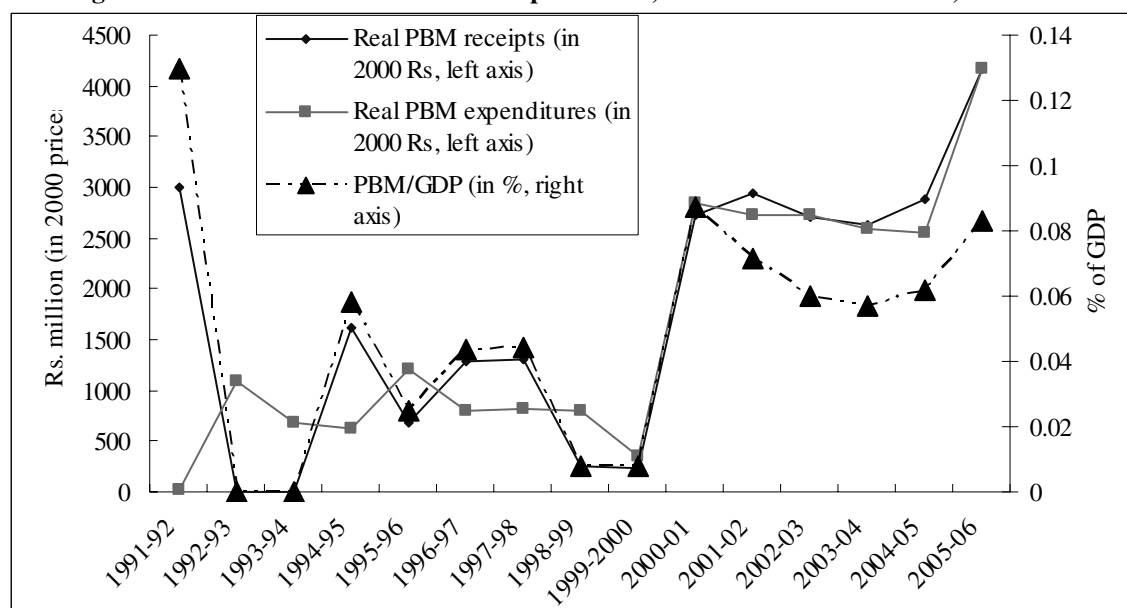
3.36 The system, however, still faces important institutional and administrative challenges. It has become clear in recent years that the PBM’s administrative capacity is insufficient to effectively manage all program components. District offices, in charge of administering an average of 10,000 cases on a regular basis, have until recently been staffed with one PBM officer, one data-entry operator, and a few support personnel. As a result PBM receives many more applications than it can process and eventually attend. Improvements in program capacity and coverage (see discussion below) will require additional financial and human resources. It is therefore welcome that PBM has taken recent steps to strengthen its district offices by creating new posts there. In addition, although program officials defend that eligibility

is determined exclusively on the basis of merit, there is no guarantee that in the future the system can be safeguarded from patronage, a risk which only strong management can fend off.⁵⁶

Financing

3.37 PBM is financed with public resources and budgetary allocations have increased significantly in recent years. Unlike Zakat the PBM is fully financed through the government's budget (Figure 3.8). Growth in the level of resources allocated to the program has been driven by the creation and expansion of the FSP, including recent increases during 2005/06 in the number of beneficiaries (from 1.25 to 1.46 million households) and the transfer amount (from Rs. 2,400 to 3,000 per year), and by the creation of a new conditional cash-transfer program (Box 3.12). Nevertheless increases in PBM resources have only partially compensated for the decline in Zakat funding so that the combined budget of both programs has fallen from around 0.4 percent of GDP in 1991-1992 to spending of about 0.15 percent of GDP in 2003/04, and dropping further to 0.14 percent of GDP in 2004/05 (Table 3.9).

Figure 3.8: Bait-ul-Mal's revenue and expenditures, in real and relative terms, 1992–2006



Source: Derived from Issues and Policies Consultants (2004).

Table 3.9: Combined expenditures by Zakat and Bait-ul-Mal (in Rs. million)

	2001/02	2002/03	2003/04	2004/05
Zakat	5583	8510	6027	6274
Bait-ul-Mal	2232	2235	2804	2703
Total	7815	10745	8831	8977
In % of GDP	0.18	0.21	0.15	0.14

Source: Derived from program documents

⁵⁶ In the absence of a formalized grievance addressal mechanism, politicians routinely make calls to the management and offices of PBM to enquire or complain about particular cases. The present management of PBM may have been able to avoid systematic mistargeting, but there is a concern that it may be far easier for the relatively better connected among the poor and destitute to get included.

Coverage

3.38 **PBM's coverage is very limited as the result of limited administrative presence and lack of resources.** Only 0.6 percent of all households interviewed by the PSNS receive PBM benefits (again, administrative records show higher coverage). Coverage is higher in rural than in urban areas (0.8 and 0.5 respectively). Similarly coverage is highest in Balochistan (1.3 percent of surveyed households) and lowest in Punjab and Sindh (0.5 percent each). As discussed earlier, these numbers fall very short of existing needs, measured using either aggregate poverty and vulnerability figures or the number of applications received by safety nets programs such as Zakat and PBM. Low coverage appears to be the result of several factors, chiefly the lack of resources for expansion. First, only 26 percent of all localities covered in the survey have a PBM office and (maybe as a consequence) knowledge about the program among potential beneficiaries is limited (i.e., only 6 percent of all households sampled for the PSNS declared to know about the program). Second, PBM's administrative capacity and budgetary resources are insufficient to effectively handle all existing beneficiaries and new applications, as mentioned above. Finally, despite similarities in their objectives, the demographic composition of PBM beneficiaries is somewhat different from that of Zakat. While Zakat provides support almost exclusively to Muslims, and within these more to Sunnis, PBM provides higher coverage to Shiites and to religious minorities, such as Hindus (Table 3.10).

Table 3.10: Coverage by religion and sect
(in percent)

Religion	Guzara	Bait-ul-Mal
Muslim	2.3	0.6
of which: Sunni	2.3	0.6
of which: Shia	1.7	1.1
Christian	0.0	0.0
Hindu	0.0	0.3
Other	0.0	0.0
No answer	0.9	0.0
Don't know	0.0	0.0
Total	2.2	0.6

Source: Staff estimates based on data from Phase I of Pakistan Safety Net Survey (nationally representative).

Targeting

3.39 **Despite the fact that no formal mechanism is used, the FSP benefits of PBM are targeted toward the poor. Although PBM's targeting appears somewhat more pro-poor than Zakat's, it could still do better.** Approximately 45 percent of PBM beneficiaries are ultra-poor and 30 percent are poor, accounting for almost 80 percent of total program resources (Table 3.3). Locations where PBM is present tend to be poorer than locations where it is not (Table 3.5). Some 46 percent of program resources flow to the bottom 40 percent of the population, less than in good conditional transfer programs internationally (Table 3.4). These results are confirmed by econometric analysis on the determinants of program selection, which show that eligibility is negatively correlated with household expenditure levels and positively correlated with some pro-poor factors (i.e., female- or elderly-headed household, mud house, etc.). Other important factors such as land ownership did not appear to play a role in determining selection though.

3.40 **Some differences in targeting exist, however, between FSP and IFA.** Survey data shows that per-capita consumption levels are lower among FSP beneficiaries than among Zakat beneficiaries, both in rural and urban areas. In contrast, anecdotal evidence suggests that there exists room for improvement in

the targeting of IFA (which gives higher benefits) since its beneficiary selection process depends heavily on recommendations by elected representatives to trigger a home visit. These results are similar to those described for Zakat, where the cash transfer components of the program also appears to be better targeted than the grant component (Permanent Rehabilitation).

3.41 In addition, the PBM lacks a formal exit policy, jeopardizing the program’s capacity to respond to changing population needs. Once households are selected into the program, particularly into the FSP, they continue to receive assistance indefinitely irrespective of whether their (economic) circumstances have changed, while new applicants are only accepted into the program to the extent that resources are available. This implies that the FSP is more likely to provide support to the chronically poor, particularly those who were poor when the program was created, than to the transitorily poor. In addition, although the IFA is supposedly designed to provide assistance to those in transitory need, lack of transparency in the selection seriously undermines the program’s complementarity with FSP.

Adequacy and impact of benefits

3.42 FSP benefits are small relative to total household income and thus their potential impact on poverty and inequality is quite limited. FSP benefits are equivalent to 11 percent of household income among the ultra poor, and to 8 and 5 percent among the poor and the non-poor respectively (Table 3.7). The low level of benefits, combined with the program’s limited coverage, imply that the potential impact of PBM on poverty and inequality—and their ability to distort work incentives—is at best small at present levels of funding.

3.43 Small benefits and low frequency of benefit payments may also jeopardize PBM’s effectiveness as a safety net. FSP benefits were until recently paid on a bi-annual basis and recently the payment frequency was reduced even further to one single annual installment. Even though small benefit levels may justify some clustering of payments in order to minimize transaction costs for both program administrators and beneficiary households, clustering undermines the extent to which program transfers contribute to consumption smoothing over time. As argued in Chapter 2, the combination of high levels of vulnerability and limited savings capacity among the poor and the vulnerable constitutes a strong case for programs that support minimum income levels on a continuous basis, instead of providing a one-time income windfall without further provisions or conditions regarding the use given to these funds.

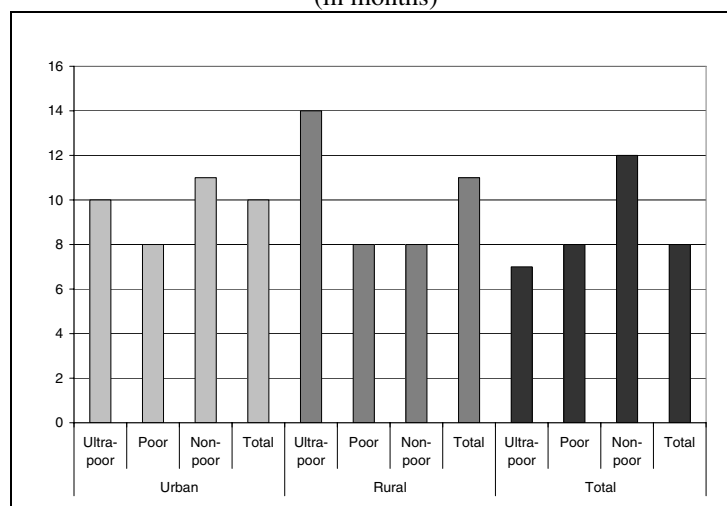
Quality of service and beneficiary satisfaction

3.44 As with Zakat, the most common complaints about PBM’s service concern the response time for payment activation after program registration, the costs associated with cashing program benefits, and the irregularity and lumpiness of benefit payments. According to the PSNS, the time elapsed from the submission of an application to PBM to the moment the first payment becomes effective varies significantly. While 20 percent of all applicants received their first payment within a month of application, 50 percent had to wait 1-6 months and an additional 8 percent declared to have waited more than a year.⁵⁷ In addition the cost of obtaining benefit payments is high both in terms of time and cash. One in ten households reported difficulty accessing the funds after being approved for assistance. FSP beneficiaries on average needed to make 1.6 visits to the payment center to obtain their assistance and more than one in twenty had to go three times or more. To this we need to add that one of every ten beneficiaries declared to have paid a bribe to obtain their benefit at some point, with bribes averaging 10 percent of the transfer (similar to Zakat). Bribes were most often paid to the PBM officer or the person in

⁵⁷ The timing would depend on the next installment of FSP benefits.

charge of payments at the local post office.⁵⁸ Finally, beneficiaries complain about installments being infrequent and lumpy. Although payments were supposed to be made bi-annually at the time of the survey, the average beneficiary waited eight months between FSP payments, with waiting times being higher in urban areas (Figure 3.9).

Figure 3.9: Average waiting time between FSP payments (in months)



Source: Staff estimates based on data from Phase II of Pakistan Safety Net Survey, which is representative of beneficiaries all over the country.

3.45 **Although a majority of beneficiaries expressed dissatisfaction with some aspects of PBM, they still viewed the assistance provided by the program as positive.** Fifty percent of beneficiaries said that benefit amounts were too low and infrequent, and a third of beneficiaries were dissatisfied with program officials. In addition, some beneficiaries declared to have been victims of stigma (18 percent) or jealousy (14 percent) as a result of their affiliation with the program. Despite all of this, almost three quarters of Zakat beneficiaries believed the assistance to be helpful.

Common challenges for Zakat and Bait-ul-Mal

3.46 **The Zakat and the PBM are among Pakistan’s most important safety nets programs, both in terms of coverage and resource allocation.** As the discussion above illustrates, however, both programs fall short of their objective of providing adequate support for the poor and the vulnerable. Interestingly, different as they are in terms of their funding and business model, Zakat and PBM share some important common features and face similar challenges on the road to increased effectiveness and efficiency. We highlight some of those challenges here and take up a more detailed discussion on possible reform options until Chapter 4.

3.47 **The potential impact of Zakat and PBM is restricted by (i) their limited coverage and low and irregular benefits, (ii) their less-than-stellar targeting, and (iii) the low quality of their services.** Limited coverage is primarily a function of insufficient resources that are spread too thin across too many subprograms and initiatives, resulting in serious exclusion errors. Both Zakat and PBM could benefit from some consolidation in terms of the various benefit modalities they offer. Benefits are low and irregular, and while they do not provide disincentives to work also are not likely to help households meet

⁵⁸ Although PBM establishes inquiry committees upon receipt of complaints, this has not been sufficient to wipe out bribery, at least as indicated by the PSNS.

even very minimum needs. Inclusion errors in targeting result from the lack of an objective targeting tool, combined with significant levels of discretion among program officials and others regarding program eligibility. Although PBM's targeting is better than that of Zakat, both compare poorly with similar programs in other countries. The use of a reliable targeting tool, together with clear selection rules for program entry and exit could go a long way in improving program effectiveness in terms of both reaching the poorest, helping the poor escape poverty, and adapting to changing circumstances over time, including aggregate shocks. (We take up exit options for program participants and program response to aggregate shocks in section B and C below). Both programs also suffer from serious service problems concerning the delivery of benefits. Strengthening Zakat's and PBM's technical and human capacity, including information management capacity, and better monitoring and evaluation would constitute a step in the right direction. Finally, there is an issue of overlap of programs, as both programs provide income support to the poor.

Box 3.5: Cash versus in-kind Transfers

In designing social safety nets, developing country governments are faced with the choice between cash and in-kind transfers. A range of economic, administrative and political considerations influence this choice (Grosh 1994; Jimenez 1993).

Economic Considerations: From an economic efficiency perspective, cash transfers are generally deemed to be superior to in-kind transfers because they do not directly influence market prices and because they offer recipients with greater freedom of choice and give them a higher level of satisfaction at any given level of income than is the case with in-kind transfers (Blackorby and Donaldson, 1988).

Administrative Considerations: Cash transfer systems require a larger and more sophisticated institutional structure than in kind transfer systems. Once that administrative system is in place, however, the costs of operating a cash transfer system are likely to be lower than that of an equivalent in-kind transfer system, such as a food stamp, public works, or commodity subsidy scheme (Grosh 1994). Unlike, food stamp or voucher programs, cash transfer programs do not need to incur the costs of printing, securing, collecting, or processing quasi-cash claims. Unlike food transfer programs, they do not require procurement, distribution, storing and distribution networks. Unlike public works programs, there is little need for site-specific design or technical supervision services. Also, the logistics of moving cash from one point to another are fairly straightforward compared with moving large quantities of a subsidized commodity. Cash is less costly to the recipient because it is universally accepted.

Targeting Considerations: One administrative disadvantage of any form of cash transfer is the fact that cash cannot be self-targeted. Unlike basic foodstuffs or housing services, an "inferior" category of cash cannot be created to ration access to the needy. Criteria for program eligibility must be established, cash must be provided only to those whose eligibility can be verified, and their eligibility must be periodically reconfirmed. This imposes a significant administrative burden even for the simplest cash transfer scheme (Blackorby and Donaldson 1988). In addition, while cash transfers are rarely distributed as "cash" per se but are more often distributed in the form of personalized checks or postal money orders, or as direct deposits (as in the US and in almost three quarters of beneficiaries in OECD countries (OECD, 1999)), many developing countries may not have the administrative infrastructure needed to operate an extensive cash transfer system. Some poor rural households may be located in areas in which home production and barter are the predominant forms of exchange, meaning that cash is only of limited use to them. However, a small (vs. large) cash transfer may achieve this goal, given high opportunity costs in claiming benefit for the non-poor vs. poor, and, targeting of food transfers can also be fraught with difficulty given the challenges of food procurement, distribution, storage and leakage.

Political Considerations: Despite the economic and administrative advantages of cash-transfer programs, it is often difficult to mobilize sustained political support for them. The fact that cash transfers convey greater freedom of choice to the recipient also creates the possibility that household members will use transfers to purchase goods and services that many governments would prefer not to directly finance, such as liquor, cigarettes, or gambling. To the extent that cash assistance is associated in the minds of the voters with consumption of "demerit" goods, this may weaken the appeal of cash assistance programs to a broad electorate. There are other reasons why politicians may favor in-kind transfers rather than cash assistance. Providing in-kind assistance is a more visible way for politicians to assure their electorate that the basic needs

of the poor have been provided for. Producers of basic goods and services (for example, builders, farmers with excess commodities, and health care providers) are also more likely to lobby politicians to provide social assistance in the form of the goods or services that they produce than they are for cash transfers. Nevertheless, recent innovations in cash transfers that condition their receipt on participation of poor in health and education programs and other income earning activities are in part addressing this concern, while at the same time improving prospects for households to exit poverty (See Tabor, 2005).

2. Social Welfare and Care Services

3.48 **Several social assistance programs attempt to support specific vulnerable groups by complementing income transfers with social services.** The main rationale for providing social services is that sometimes access to specific services, rather than or together with lack of income, constitutes the most important limitation for poverty alleviation and welfare improvement. These programs help individuals who experience welfare losses, e.g., loss of parents, disability, divorce/other family, through improving their access to a range of services, including, *inter alia*, legal services, psycho-social support, community-based rehabilitation, foster and adoptive care. Social welfare and care services are publicly financed, but service delivery can be, and is increasingly being, contracted to private providers.

Table 3.11: Budget for federally implemented social care services, 2003/04

Agency / program	Budget / Expenditure	
	(Rs. Million)	% of total social assistance budget
Directorate General of Special Education	177	0.90
National Commission for Child Welfare and Development	4	0.02
National Council for The Rehabilitation of Disabled Persons	23	0.12
National Trust for the Disabled	147	0.75
Bait-ul-Mal social care programs:		0.00
Institutional rehabilitation (NGOs)	43	0.22
National centers for the Rehabilitation of Child Labor	147	0.75
Dastkari vocational training schools	24	0.12
Total	565	2.88
Total as % of GDP	0.01	

Source: Yearbook 2003/04, Ministry of Social Welfare and Special Education.

3.49 **The Ministry of Social Welfare and Special Education has been active in designing and providing several types of social welfare and care services programs for vulnerable groups,** e.g., working children, vulnerable women and disabled. The programs are publicly financed and administered by the federal government in some instances (e.g., special education schools for children with disabilities; PBM child labor or vocational training centers); provincial governments (beggar and drug addict homes; Punjab Child Protection Bureau); and districts (district social welfare offices). Some of the main service initiatives are:

- **To address child labor, the Bait-ul-Mal runs several National Centers for Rehabilitation of Child Labor (NCRCL).** By 2007, PBM had established 149 NCRCL across Pakistan and another 1 is planned. Children enrolled in NCRCL receive free primary education (completed in three years instead of the usual five), clothing, footwear, books and stationery. To compensate families for the opportunity cost of sending their children to school, enrolled children receive a stipend of Rs. 10 per day and their parents are paid Rs. 300 per month, translating into a total incentive of Rs. 600 (\$10) per month. The program also offers teachers a higher-than-average salary to teach in NCRCL in the hope of attracting academically better-qualified teachers capable of imparting primary level education in a reduced time. The maximum enrollment per centre is 120 children and around 18,000 children

are currently enrolled under the program. The program has a budget of Rs. 147.2 million (around 0.75 percent of the total social assistance budget), or the equivalent to Rs. 1.9 million per centre or Rs. 15,000 per child per year.⁵⁹

- **To improve employment prospects of vulnerable groups. The Bait-ul-Mal provides training to orphans and poor girls and widows.** The Dastkari/Vocational Training Centers, implemented by PBM, provide free training to widows, orphans and poor girls in different skills with the overall objective to make them self-reliant. Some 124 schools are operational, and another 26 are planned. An independent review of the Dastkari Schools, commissioned by the Ministry of Women Development, concluded that unless the program is revamped with a greater focus on market oriented skills it is unlikely to have any significant impact on skills development of women in the targeted segments of the population.
- **To address disability. The Ministry of Social Welfare and Special Education implements several programs and has formulated a national policy and plan of action for addressing disability.** To promote inclusive education, Pakistan has a network of Special Education Centers and other similar facilities providing education to students with more severe disabilities. Official estimates suggest that only 1.7 percent of students with special needs are served by these schools. The Government also encourages employers to hire workers with disabilities and has raised the job quota for persons with disabilities from 1 to 2 percent of all formal sector jobs. However, anecdotal evidence suggests that these provisions are not enforced.
- **To develop an over-arching framework and develop a more consistent approach to addressing disability. The Ministry of Social Welfare and Special Education formulated the National Policy for Persons with Disabilities.** The policy and its associated action plan aimed to create an environment in which persons with disabilities could realize their ‘full potential’ through ‘inclusive mainstreaming’ and ‘empowerment’. Areas of focus include prevention, early detection, provision of services, inclusive education, vocational training and employment, research and advocacy. Since the plan’s approval some efforts have been made toward implementation, but important challenges in mainstreaming disability remain.

3.50 **Current programs are fragmented and no over-arching framework for service provision to vulnerable groups exists.** The fragmentation of programs *across groups*, e.g., for child labor, vulnerable women and children and disabled and *across several public agencies* without clear prioritization of services reduces the impact of programs and their ability to address welfare. The lack of clear identification of vulnerable (e.g., using a similar or the same criteria as cash support programs) likely impedes the targeting of program resources (together with income support) to those truly in need.

3.51 **Public financing of social welfare and care services is low relative to existing needs, resulting in deficient coverage.** Federal government expenditures on social care services in 2003/04 was around Rs. 565 million (less than 3 percent of total social assistance spending, Table 3.11). These low aggregate levels of resources (coupled with program fragmentation noted above) inevitably lead to poor coverage and weak administrative capacity to deliver services and monitor and evaluate initiatives.

⁵⁹ Aside from this initiative to limit the supply of child workers, there are efforts to reduce the demand of child workers from employers. Recent pressure from foreign corporations on local companies that employ child labor (e.g., export oriented sports and surgical goods industries) has also helped reduce the demand for child labor in the country. However, these efforts are limited and the incidence of child labor remains considerable—2.5 million children aged 10-14 (16 percent of all children in that age) and an unknown number below age 10 are working.

3.52 **The public sector's role in service provision is currently focused on delivery instead of policy development, setting service standards, regulation and supervision.** The Ministry of Social Welfare and Special Education, its associated agencies, and provincial governments are involved in program delivery (e.g., through the National Disability Trust), and contracting of services with private providers (see below) has not been fully exploited. The more appropriate role of the Ministry in policy development and overall regulation and supervision of services needs to be considerably strengthened. This includes determining eligible vulnerable groups (in conjunction with the income support programs), developing a menu of priority services, establishing service standards, licensing, regulating, and supervising service providers, and monitoring and evaluating program impact. Funding service provision through public-private partnerships could also be considered.

3.53 **Private provision of services by NGOs to vulnerable groups exists, but their coverage is also limited.** Several NGOs are involved in providing services to vulnerable groups, often financed through charitable donations and, to a lesser extent, through public funding. Several NGOs such as the Edhi Trust are well known and have been active in providing a range of services (often related to health or education) to poor and vulnerable groups. For the disabled, there are also a number of organizations that provide services, e.g., Khalid Nizami Disability Fund, the Organization for the Rehabilitation of Disabled Persons, STEP and Milestones Society for Special People. However, most of these organizations are based in urban areas and concentrated in Punjab and Sindh, leaving large rural areas and other provinces uncovered. More recently, in response to the earthquake, the provision of community based welfare and care services to disabled groups in earthquake affected areas is being implemented through the partner organizations (e.g., Rural Support Programs) of the Pakistan Poverty Alleviation Fund.

Box 3.6: Disability in India

A careful assessment of disability in India concludes that a multifaceted approach is needed for disabled people to realize their full individual potential and to maximize their social and economic contribution to society. The situation of PWDs is heterogeneous, and so are the policy options for different groups of disabled people. There are substantial differences in socio-economic outcomes, social stigma, and access to services by disability type, with those with mental illness and mental retardation in a particularly poor position. Among other things, the study concludes that:

- The official estimates of the incidence of disabilities, around 2 percent of the population were found to underestimate disability. The true incidence is more like 4-8 percent of the population.
- Physical and mental impairments are compounded by poor education outcomes. PWDs have excess illiteracy rates and children with disabilities have out of school rates five and a half times the general rate.
- Efforts to minimize disability (e.g., immunization, early detection, better outreach for rehabilitation) will be critical, but more effective efforts to ensure inclusion of disabled in basic services (e.g., inclusive education, health, social protection programs) will also be required.
- Prevention will require strengthening preventive and curative health care services.
- Inclusion can be strengthened through improvements in available information on disability and reducing stigma.
- Better outcomes will require stronger coordination of efforts within the public sector, engagement between public and non-public actors, and mobilization of actors in local governments and community institutions.

Source: World Bank, 2006c.

Challenges for Social Welfare Services

3.54 **The Ministry of Social Welfare and Special Education is aware of these issues and has announced its intention to strengthen service provision to special vulnerable groups.** The Ministry

has signaled its intention to strengthen social welfare services, particularly at the community level, in partnership with private providers. To do, so the Ministry intends to strengthen program administration (human and physical resources), in particular its ability to develop policies and its capacity to fund, monitor, and regulate and evaluate services (see Box 3.7).

Box 3.7: Earthquake social protection response

The Ministry of Social Welfare and Special Education has formulated a plan to strengthen its organizational, institutional and human capacity, as well as that of the Provincial and District Social Welfare departments, to implement the National Social Protection Strategy (under preparation) and the National Plan of Action for the Protection of the Most Vulnerable Population in Earthquake-affected areas. The plan includes (i) the establishment of a dedicated Social Protection Unit within the Ministry with the capacity to guide and evaluate pilot programs; (ii) strengthening of core competencies of senior and mid-level staff; (iii) launch of a staff development program; (iv) conducting a rapid assessment of institutional, organizational, and human capacity in earthquake affected areas, to pilot an assessment methodology for a country wide assessment; and (v) building the capacity of Social Welfare departments in earthquake-affected areas.

B. Supporting Exit from Poverty

3.55 Basic income support and services help address chronic poverty and provide minimum support those who fall into poverty because of a shock, but more effort is needed to help the poor escape and remain out of poverty. Several programs are geared to promoting exit from poverty. For the working poor, these programs include microfinance programs that provide access to credit (and hence income) for the poor and public works programs that generate employment (and infrastructure). For children, these programs include conditional cash transfer programs that make income support conditional on participation in health and education programs. As was the case with income support and basic services programs, if well designed these initiatives can also be used by the poor and the vulnerable as coping mechanisms in the event of a shock.

1. Access to income earning opportunities for the poor

3.56 Efforts to increase access to income generating opportunities among the *poor of working age* in Pakistan have been concentrated around microfinance (MF) programs and public works programs.⁶⁰

Microfinance

3.57 Because of extensive market failures in financial markets, microfinance institutions can potentially play an important role in providing credit and other financial services to low income households.⁶¹ International evidence suggests that microfinance programs can have very positive impacts on reducing poverty. The most successful MF programs are profitable and depend little or not at all on donor funding, relying instead on commercial sources of funds. They offer loans and an array of financial services, including micro-insurance. Program evaluations indicate that microfinance programs have had a positive impact on the welfare of their clients. By increasing earning and savings, financial services have allowed poor households to make the transformation from ‘every-day survival’ to planning for the future.

⁶⁰ The country has also developed many training programs (see for example discussion of Bait-ul-Maal above), but an in-depth discussion on these is outside the scope of this report and is being handled in a contemporaneous World Bank report on Labor Markets.

⁶¹ For a review of literature, see del Ninno and Dorosh, 2001, Matin and Hulme, 2003, CGAP, 2006, Littlefield, Murdoch, and Hashemi (2003).

Improving the permanent earnings of their clients has led households to send their children to school, increased nutrition outcomes and reduced poverty.⁶²

3.58 In Pakistan, MF is offered mainly through the banking sector (Khushali Bank) and a number of NGOs, many of them affiliated with the Pakistan Poverty Alleviation Fund (PPAF). All these institutions provide lines of credit for rural and urban low-income households. Khushali Bank offers short-term loans ranging up to \$500 for working capital and purchase of productive assets. It also proactively mobilizes deposits and provides financial counseling to its clients. The bank promotes its business through community meetings in which potential borrowers are identified, and after due diligence, credit is advanced. It also offers repeat lending to borrowers with good repayment record, opening up a “line of credit”. The PPAF is a wholesaler of funds to partner organizations (NGOs) offering three main products: lines of credit for expansion of poverty-targeted micro-credit programs, grants and loans for building community infrastructure, and grants to strengthen and build the institutional capacity of partner organizations. After the earthquake of October 8, 2005, PPAF also entered into relief and reconstruction. Many of the partner organizations are members of the Rural Support Network of NGOs, including the National Rural Support Program (NRSP). NRSP now operates in 73 districts, has extended credit to over a million individuals, and has financed a large volume of community level physical infrastructure.

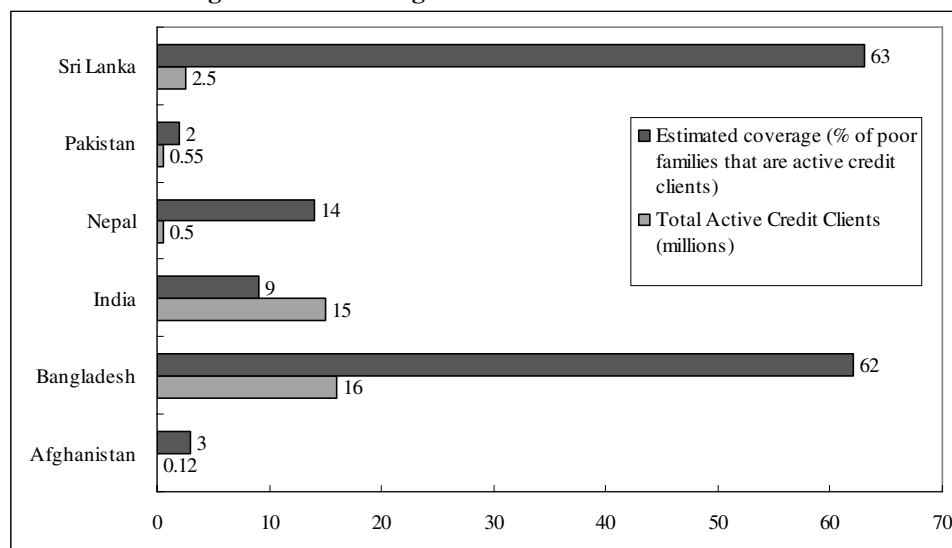
Box 3.8: Bangladesh: Vulnerable Groups Development Program

Bangladesh has addressed this problem through an innovative program called Vulnerable Group Development (VGD). VGD assists almost half million very poor households by providing first food aid, as a breathing space, and later training for life-skills and skills needed for income generation. After this, most beneficiaries ‘graduate’ to become MF clients, building new livelihoods based on micro assets. Graduation allows the program to continuously reach new beneficiaries among the very poor. Impact evaluations of VGD show that program participation helps increase consumption and income levels for beneficiary households compared to non-beneficiary households (World Bank 2005c).

3.59 The MF sector has limited coverage in Pakistan relative to other countries in the region. Pakistan has around a half million active MF clients (Figure 3.10). The coverage of micro-finance organizations in Pakistan is lower than most South Asian countries. After only four years of operations, the coverage of microfinance was already higher in Afghanistan than Pakistan. The slow growth of MF in Pakistan is caused in part by the lack of a solid and profitable core business, relying on subsidized donor funds instead of profitability (Rasmussen, 2005).

⁶² See del Ninno and Dorosh (2001), Matin and Hulme (2003), CGAP (2006), Littlefield, Murdoch and Hashemi (2003).

Figure 3.10: Coverage of microfinance in South Asia



Source: Rasmussen (2005).

3.60 **The impact of existing MF schemes for those who do receive credit appears positive.** An assessment of Khushali Bank’s micro credit program concludes it has positive impacts on both economic and social indicators of welfare, as well as on income-generating activities, especially among the very poor (Montgomery, undated). There is evidence of positive impacts on agricultural and non-agricultural sales, expenditures on children’s education and health care (Montgomery, undated). The bank has generated these impacts while remaining focused on the goal of financial sustainability. Similarly an evaluation of PPAF’s conducted by Gallup showed that borrowing households were better off than non-borrowing household, with the former realizing gains in income, consumption, and personal and business assets. The mean return on investments financed through loans was approximately 30 percent per annum (PPAF, 2004).

3.61 **However, MF fails to target the poor and the ultra poor.** Most Pakistani MF institutions do not offer loans that are sufficiently small to be of relevance to the poorest. As a result less than 2 percent of poor households borrowed from NGOs or banks (Figure 3.10). Instead low-income households borrow from friends and relatives, but also from shopkeepers, moneylenders, and landlords, often at usurious rates. Lack of outreach to the ultra-poor also plagues other micro-credit programs, given that the very poor need extra training and outreach to become successful clients, and not all poor have entrepreneurial skills. However, this problem is more severe in Pakistan. In Bangladesh and Sri Lanka, over 60 percent of the poor are micro-finance clients. The microfinance coverage of the poor is lower in India and Nepal, 9 and 14 percent, respectively, but still far higher than in Pakistan.

3.62 **For this reason, microfinance organizations are increasing their outreach to safety net programs which serve the poorest groups.** The Consultative Group to Assist the Poor (CGAP) and other microfinance organizations are placing considerable emphasis linking up with safety net schemes (that reach the poorest groups) to help beneficiaries with entrepreneurial ability gain access to micro-finance programs (Hashemi, 2006). Training poor beneficiaries in the bureaucratic formalities (forms, etc.) for accessing microfinance schemes, helping them to start-up savings, and giving them small start-up loans are some of the ways in which the poor can become viable clients of microfinance organizations. Similarly, many safety net schemes are increasingly finding it important to train their clients to access micro-credit (and training/skills) in order to escape poverty. The most successful example of a program

that has exploited this synergy between safety nets and microfinance schemes is the Bangladesh VGD program, which has helped many extremely poor women escape poverty through training that enables them to access and use micro-credit schemes (Box 3.9).

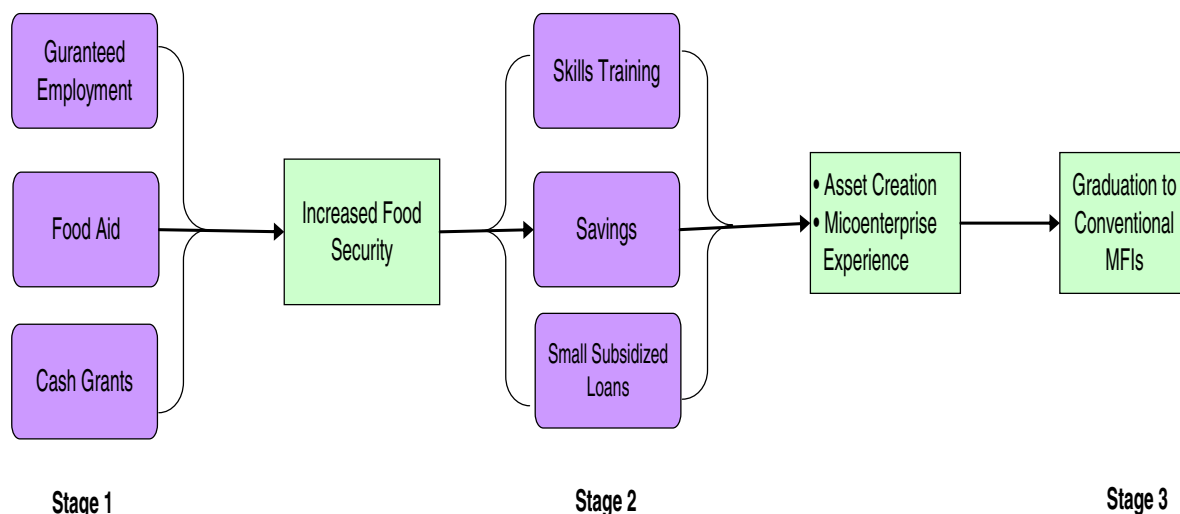
3.63 **Important challenges remain, however.** These can be summarized as follows:

- *The MF sector needs to expand coverage.* Achieving impact requires scaling up and deepening outreach. MF institutions have failed to grow their outreach at the speed seen in other developing countries. Although more research is needed on the reasons for slow MF expansion in the country, regulatory constraints do not appear to be a major issue. Pakistan needs to build strong, profitable MF institutions that are able to expand outreach using low cost approaches.

Box 3.9: Moving from Income Support to Self-Employment

Microfinance may reach low-income households, but many countries have found that the very poor are unlikely to benefit, because of social stigma and inability to repay loans. Bangladesh has addressed this problem through an innovative program called Vulnerable Group Development (VGD). VGD assists almost half million very poor households by providing first food aid, as a breathing space, and later training for life-skills and skills needed for income generation. After this, most beneficiaries ‘graduate’ to become MF clients, building new livelihoods based on micro assets (World Bank 2005c). Graduation allows the program to continuously reach new beneficiaries among the very poor.

Sequencing for Graduation to MFIs



Impact evaluations of VGD show that program participation helps increase consumption and income levels for beneficiary households compared to non-beneficiary households. Most households benefiting from cash transfer programs have increased household income and the quality and quantity of food-intake, reducing the poverty level of beneficiaries.

Source: del Ninno and Dorosh, 2001, Matin and Hulme, 2003, CGAP, 2006, Littlefield, Murdoch, and Hashemi (2003).

- *The MF sector needs to increase its menu of financial products.* Few products are offered apart from loans. Some of the potential microfinance products in Pakistan are savings services, health insurance, group life insurance, money transfer services, housing loans, etc.

- *Pakistan's MF sector could better target the poor and women, for example, through very small and flexible loans.* The microfinance sector could also consider expanding its efforts in conjunction with income support programs—to meet the existing demand for credit among low income groups—particularly for the entrepreneurial poor, through appropriately designed and privately provided training programs.

Workfare Programs

3.64 **Public works or workfare programs have the objective of creating critical local infrastructure that can help generate income earning opportunities for the poor.** Depending on the complexity of the works, these programs are often contracted to the private sector and use skilled labor. However, sometimes there are stipulations on private contractors to use local or poor labor. Other works programs, often far less complex (seeding, cleaning up, small works.) can, if wages provided are low and programs are well administered, be self-targeted to the poorest households. These programs can act as a screening device for cash transfer programs (i.e., cash transfer is provided conditional on work). If undertaken in slack seasons or in times of natural disasters, can also can help smooth household consumption against shocks in employment (seasonal unemployment or natural disasters)—a topic taken up in the next section.⁶³

3.65 **Pakistan has implemented several public works type programs** to provide temporary employment to vulnerable groups. While the country has several small-scale rural infrastructure programs, the main public works programs that have been implemented in Pakistan include: workfare for Afghan refugees, the Khushal Pakistan Program, and the Rural Support Program. However, at present the country does not have any major workfare program. There may be scope for developing workfare programs in Pakistan to meet the needs of generating infrastructure, local employment and seasonal downturns.

3.66 **Three public works projects targeted to the Afghan refugee population in Pakistan were implemented in the 1984-1996** period by the United Nations High Commission for Refugees with World Bank assistance. While no rigorous randomized evaluation of the program was undertaken, a program evaluation concluded the program had met its employment creation objective very successfully: Nearly 22.6 million person days of employment was created over a 12-year period, of which refugee person days amounted to 17.2 million and local Pakistanis accounted for the rest, exceeding planned levels. There was also a transfer of skills to participants enabling some Afghan laborers to successfully assimilate and seek employment in the Pakistani economy as skilled workers (World Bank, 1996). The program was labor intensive. Overall, 295 labor-intensive projects were executed by contractors, and these projects created many durable assets for the benefit of local host populations (Sub-projects included tree seedling production, home energy conservation, road construction, drainage and flood control works, and forestry and conservation projects). The wage rate was set low—15 to 20 percent below the local market wage rate for casual unskilled labor—to attract the most vulnerable workers. However, the regular employment provided by the workfare program was attractive for poor refugees. Key factors that contributed to the success of the program included a capable and experienced implementing agency, clearly established criteria for selection of projects, effective monitoring and supervision, and the willingness of the refugees themselves to work and earn rather than being dependent (World Bank, 1996).

3.67 **For Pakistanis, the government later launched the Khushal Pakistan Program aimed at generating economic activity and employment through public works.** Khushal Pakistan covered 17

⁶³ In this sense, though non contributory, workfare programs act as an informal unemployment 'insurance' program for the poor.

types of activities such as farm-to-market roads, water supply, sanitation, etc., and the program provided temporary employment to 0.9 million persons. No targeting was employed. The character of the program was later changed and renamed Tameer-e-Pakistan under which each member of the National Assembly was allotted Rs. 10 million per fiscal year for small infrastructure schemes in their constituencies. Under the revised Tameer-e-Pakistan program, the emphasis is more on providing access to basic utilities and infrastructure in the constituencies than on providing temporary employment generation for the poor. Work is performed by contractors using crews of professional workmen, who may or may not be local, or poor, Tameer is therefore not a workfare program in the conventional sense. It remains to be evaluated. Most recently the government has announced a new Khushal Program, though its parameters are yet to be fully defined.

3.68 Finally Pakistan's Rural Support Programs, modeled after the Aga Khan Rural Support Program, generate employment for communities, though its primary purpose is social mobilization. Rural support programs empower communities to improve their own well-being by mobilizing village savings. Matching grants to communities are provided to identify and develop viable small scale infrastructure or other projects chosen by village organizations to benefit the community as a whole. Villagers are employed for building the infrastructure (e.g., feeder road, well, etc.), which contributes to higher income for the community as a whole, but is not a workfare program per se. Program evaluation, taking into account the many objectives of the program, is currently underway.

2. Promotion of human capital accumulation for the poor: Conditional Cash Transfers

3.69 As the discussion in Chapter 2 made clear, education and health outcomes for the poor and vulnerable are significantly worse than those of their non-poor counterparts. These differences not only jeopardize the ability of the poor to access productive economic opportunities in the short-term, but also significantly diminish the probability that future generations will be able to escape poverty and vulnerability, hence contributing to the perpetuation of these problems. Although there is no doubt that sound education and health policies constitute the basis to improve social outcomes, social assistance can also play a role in providing families with complementary services (for instance, through feeding programs) and additional incentives to increase utilization of existing facilities (for instance through conditional cash transfer programs that make the receipt of a social assistance conditional on participation of children in school and children (and sometimes their mother) in health and nutrition programs.

3.70 In Pakistan, there are currently several cash/in kind income support initiatives, mostly pilots, aiming to increase human development outcomes. There are three cash transfer programs that aim to increase school enrolment and attendance, one in-kind transfer program that aims to improve both the nutrition and education status of the poor children, and one cash transfer program that targets improvement of health status alone.

3.71 First, the provinces provide free textbooks to all students enrolled in public schools and, in some cases, provide income support via education stipends to girls in middle school from poor districts. Provinces, particularly Punjab also have designed their own stipend programs. Data from the PSNS shows that the provincial free textbook programs have extensive coverage and are well targeted, while the stipend program has very limited coverage. More than 40 percent of all children ages 5 to 9 receive free textbooks. Coverage is higher in rural than in urban areas (64 and 30 percent

Box 3.10: Workfare Programs: Experience from Argentina and India

Well designed workfare programs (e.g., Argentina Trabajar Program and the Maharashtra Employment Guarantee Scheme) can provide employment to help the poor manage unemployment risks, help create public infrastructure that helps poor increase long term income, with spillover benefits in terms of social gains. If wage levels are kept low enough (sometimes a political issue), programs also have the advantage of self-targeting to the poor.

Self-Targeting: In 1996, the government of Argentina responded to high levels of unemployment by starting *Trabajar*, a public workfare program. The program was designed to provide temporary employment benefits to poor participants. The main targeting mechanism adopted was the low wage rate, supplemented by a sub-project selection process that geographically targeted poor areas to receive projects. To avoid political problems over 'minimum wage', the payment to a worker is not called a "wage," rather it is termed "subsistence" or "economic assistance." In India, *The Maharashtra Employment Guarantee Scheme* (MEGS) also provided every registered participant guaranteed employment at the minimum wage rate within a radius of five kilometers from his or her home. Targeting outcomes for both programs were excellent. Nearly, 60 to 70 percent of households participating in India's nationwide program, the MEGS, and in Argentina's Trabajar program belonged to poor households (Jalan and Ravallion, 1999 and Subbarao, 1997). Raising wage rates can reduce targeting impact. In 1998, the MEGS program had to raise its wage rate in response to increases in the national minimum wage. Research by Datt and Ravallion (1994) has confirmed that the upward revision of the wage rate in 1988 contributed to job rationing and eroded the "guarantee" of employment expected of the program. Gaiha (2000) also noted that targeting efficiency was eroded by the wage hike.

Consumption Smoothing: India's nationwide program of Jawahar Rojgar Yojna (JRY) operated intensively during agricultural off-peak seasons; annually as many as 55 million people were employed through this program during the off-season. Thus, the JRY conferred significant stabilization (consumption-smoothing) benefits (the transfer benefits were lower than in the case of MEGS and Trabajar) The Maharashtra Employment Guarantee Scheme (MEGS), also conferred consumption smoothing benefits to workers. Walker and Ryan (1990) showed that the risk (stabilization) benefits conferred by the scheme remained significant and continued to be so even after 1988 wage hike because the scheme continued to operate intensively in off-peak agricultural seasons (Subbarao, 1997).

Labor Intensity: To generate employment, it is important that workfare programs have high labor intensity: In the MEGS, the wage bill represented 60 to 70 percent of total cost. Similar ratios were realized in the Bangladesh Food for Works Program. In Argentina's Trabajar program, depending on the type of project that was being built, the share of labor costs ranged from 30 to 70 percent. The average share of labor costs for the program as a whole was 40-50 percent of total project costs. In Korea too, labor costs amounted to close to 70 percent.

Social gains and poverty reduction: It appears that well-designed workfare programs do have the potential to confer significant social gains. For example, India's Maharashtra Employment Guarantee Scheme was designed to encourage the participation of women. Employment was provided close to their places of residence, creche facilities were provided, and male-female wage discrimination was eliminated. As a result, close to half of all participants were women. Datt and Ravallion (1992) have quantified the impact of the program and found that the severity of poverty has fallen from 5.0 percent to 3.2 percent owing to participation in the MEGS.

See Subbarao (2000).

Box 3.11: Conditional Cash Transfer Programs – Mexico’s Progresa Program

Conditional cash transfer programs target income support to households conditional on their participation in health and education programs.

Conditional cash transfer programs seem to have originated in South Asia before being reinvented in Latin America. In 1993, Bangladesh launched the Food for Education, replacing a poorly targeted rural food rationing system. Households received 15 kg wheat per child per month (but maximum 20 kg per family) conditional on all their children enrolling in primary school. Because of the difficulty of managing the logistics of food distribution, the government decided to switch from food to cash for education. Very small amounts are given—the average transfer corresponds to US\$2.4 per household per month or 4 percent of the poor’s total consumption. Yet the impacts have been favorable—targeting outcomes are excellent, there has been a sharp increase in enrolment, especially for girls, who now outnumber boys in terms of enrollment, and child labor has been reduced. The program covers 2.1 million students with a budget of around US\$77 million.

The *most recent or second generation* conditional transfers were initiated in Latin America. These programs provide a single uniform cash benefit to the poor (targeted) conditional on their participation in health, nutrition, and education programs. Mexico’s *Progresa* is an example of this type of unified program. In 1995, a new government in Mexico was faced with a macroeconomic crisis which sent poverty skyrocketing. Given a history of ineffective programs in the past, the government decided that a new approach to poverty alleviation was needed. The new approach had four goals; it would encourage long-term investment in human capital by the poor; it would recognize the synergies between health, nutrition, and education; it would aim to change attitudes and behaviors; and in order to counter political interference, the program’s goals, rules, requirements, and evaluation methods would be widely publicized. The resulting *Progresa* program linked cash transfers, administered by the Ministry of Social Welfare, to health clinic visits, nutrition and hygiene information, and school attendance—in partnership with other line Ministries (Health and Education). Several rigorous impact evaluations have shown impressive results:

(a) Very good targeting—60 percent of benefits went to households in the bottom quintile and 80 percent to households in the bottom 40 percent (none of Pakistan’s programs come near to this).

(b) Girls’ enrolment in middle school increased from 67 to 75 percent, and boys’ from 73 to 78 percent.

(c) Child labor was reduced, and school retention was improved.

(d) The incidence of low height for age was reduced, and preventive health care visits improved, helping illnesses to drop 25 percent among newborns and 20 percent among children under 5. Anemia in children 2-4 fell 19 percent, and adult health also improved.

On the basis of this evaluation, the new Government decided not to disband the program, but rather to scale it up. The only change was a renaming of the program to *Oportunidades*. The program now covers around 21 million beneficiaries, one-fifth of Mexico’s population.

The success of *Progresa*—demonstrated by the impact evaluations—has led to the development of CCT programs in many other countries, including Brazil, Cambodia, Chile, Colombia, Ecuador, Honduras, Jamaica, Nicaragua, and Turkey. A number of rigorous scientific impact of these programs have documented that well implemented CCT programs designed appropriately for their settings can have a wide range of desirable outcomes: excellent targeting, increased quantity and quality of food consumption, increased use of preventive health services (immunization, growth monitoring). School enrollments have improved in many countries and grade-for-age levels and child labor decreased in some programs.

Sources: World Bank (2003), Rawlings (2004); Maluccio and Flores (2004); Das, Do, and Özler (2005); Skoufias and McClafferty (2001).

respectively) and in Punjab than in other provinces (Table 3.12). In contrast only 2 percent of all surveyed children receive a stipend (Rs. 200 per month). Conditional on attending school, poor children and girls are more likely to receive free textbooks than non-poor, both in rural and urban areas.⁶⁴ In the absence of an objective targeting tool, good targeting outcomes can be attributed to poor households having more

⁶⁴ The incidence of stipends is too low to assess its distribution.

children than non-poor ones and, conditional on enrolment, public school enrolment being higher among poor than non-poor children. In addition, it is important to point out that books seem to be delivered timely at the beginning of the school year in 95 percent of the cases. Finally, although results from an ongoing impact evaluation are not yet available, preliminary evidence for Punjab's stipend program suggests positive impacts of the education sector reform program (of which free textbooks and stipends form part) on overall enrolment rates. Specifically, enrolment rates increased from 45 percent in 2001 to 58 percent in 2004/05. This translates into one million more children enrolled in Punjab schools since the launch of Punjab's education reform program.

Table 3.12: School attendance and receipts of free textbooks, by sector, quintile, and program status

Quintile	Children aged 5-9				Children aged 5-9 in families receiving Guzara				Children aged 5-9 in families receiving Bait-ul-Mal			
	Attending school		Received free textbooks		Attending school		Received free textbooks		Attending school		Received free textbooks	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
1	58.9	48.3	68.9	70.2	41.6	33.6	55.1	90.2	54.8	46.7	85.2	67.3
2	64.2	55.5	68.6	60.3	59.6	34.1	78.6	93.2	50.1	45.8	84.9	76.6
3	67.0	60.1	55.3	50.8	45.8	65.8	43.7	44.1	48.2	43.1	68.4	72.2
4	69.4	65.2	45.8	47.6	60.6	61.1	44.3	23.6	70.8	76.5	83.6	73.6
5	75.2	71.7	33.3	33.2	40.6	38.8	23.7	52.4	93.6	48.1	44.3	-
<i>Total</i>	<i>65.7</i>	<i>58.0</i>	<i>56.7</i>	<i>54.3</i>	<i>50.1</i>	<i>43.4</i>	<i>54.3</i>	<i>57.1</i>	<i>55.7</i>	<i>48.8</i>	<i>79.1</i>	<i>67.3</i>
Location												
Urban	73.5	71.6	31.1	30.8	54.3	44.4	53.3	54.3	46.6	42.7	62.7	80.4
Rural	61.7	51.5	68.5	67.8	51.4	44.9	56.2	57.5	61.6	52.9	80.8	64.3
<i>Total</i>	<i>65.2</i>	<i>57.9</i>	<i>55.7</i>	<i>53.2</i>	<i>51.9</i>	<i>44.8</i>	<i>55.6</i>	<i>56.8</i>	<i>56.5</i>	<i>50.0</i>	<i>75.4</i>	<i>68.3</i>
Province												
Balochistan	53.4	52.7	26.9	28.3	68.3	84.4	4.4	11.7	43.9	63.8	57.1	36.0
NWFP	70.7	59.0	66.9	60.7	46.1	37.3	39.2	62.4	58.6	50.7	75.3	75.6
Punjab	72.3	66.1	61.8	58.5	58.5	49.5	81.4	83.9	68.1	57.6	75.7	74.1
Sindh	49.3	40.0	36.6	37.3	46.5	29.9	46.9	54.3	37.7	34.6	79.9	64.9
<i>Total</i>	<i>65.2</i>	<i>57.9</i>	<i>55.7</i>	<i>53.2</i>	<i>51.9</i>	<i>44.8</i>	<i>55.6</i>	<i>56.8</i>	<i>56.5</i>	<i>50.0</i>	<i>75.4</i>	<i>68.3</i>
Sample size=	13,123	10,884			264	200			168	143		

Notes:

Textbook receipt is conditional on child attending school. No filter to distinguish between public and private schools.

Totals for quintiles and province/rural/urban are different since household expenditure information is missing for some households.

Quintiles are calculated based on self-reported monthly household expenditure on food and non-food items (12 month recall)

Expenditure aggregates are deflated with provincial and rural/urban deflators.

Source: Staff estimates based on data from Phase I of Pakistan Safety Net Survey. Quintiles in this table are based on brief, self-reported income, not a full expenditure module.

Box 3.12: Bait-ul-Mal is Piloting a Conditional Cash Transfers in Pakistan

Pakistan is beginning to implement a new Child Support Program (CSP). CSP is a conditional cash transfer for education targeted to existing beneficiaries of the Food Support Program (FSP). CSP will provide an additional benefit, over and above the regular FSP benefit, to FSP beneficiaries provided their children of school-going age regularly attend school.

Under CSP, a family with one child aged 5-12 will receive additional Rs. 200 per month, while a family with two or more children between 5 and 12 years will receive additional Rs. 350 for as long as they keep all their children 5-12 enrolled in school and attending at least 80 percent of the time. Families with no children of school going age or whose children do not attend school will continue to receive the regular FSP benefits and will therefore not lose out as a result of this new program.

CSP started as a pilot in five districts during 2006/07. A rigorous scientific impact evaluation, based on comparisons of outcomes with a control group of FSP beneficiaries not receiving the CSP transfers, is ongoing. Depending on the outcome of this evaluation, the pilot could later be scaled up to cover the entire country.

3.72 Other education based income support programs provide monthly cash transfers to poor households conditional on school enrolment and attendance.

- The first program, headed by National Education Foundation, pays Rs. 200 per month to poor households conditional on their children enrolling in primary school. The pilot operates in a few sites in Punjab, Northern Areas, and Islamabad Capital Territory, targeting households with (self-reported) income below Rs. 3000 per month.⁶⁵ An interesting feature of the program is the provision of complementary financial support to participating schools intended to help schools raise their standards of education quality. The ongoing program evaluation can potentially measure the impact of both demand and supply-side factors on school enrollment and attendance.
- The second conditional cash transfer program, the Child Support Program (CSP), is linked to the safety net and managed by the Bait-ul-Mal (Box 3.12). The program pays additional income support to current recipients of the FSP program conditional on school enrolment and attendance. The targeting of the CSP is therefore similar to the FSP, although targeting improvements are envisioned over the course of the pilot. A rigorous impact evaluation is being designed for this pilot program.

3.73 The school-feeding program (Tawana) is an in-kind transfer program intended to improve both health/nutrition status and enrollments in education. The Tawana program is implemented by the Ministry of Social Welfare and Special Education in collaboration with Bait-ul-Mal, provincial and district authorities and NGOs. It targets girls in 3,414 rural schools in 29 poor districts schools, but cooked mid-day meals are also provided to boys in co-ed schools. The total budget for the program is Rs. 700 million (3% of the total social assistance budget), or around Rs. 7 per day per student. The impact of the program is not well known. However, the program has encountered resistance for expansion and has been subject to criticism from province and district authorities, who argue that its somewhat complex design, together with the need to comply with public sector procurement rules pose an undue burden. These implementation issues are not dissimilar to those affecting other school meals (and other in kind) programs worldwide, including issues of distribution, leakage, and storage of food (see Box 3.13).

3.74 Finally, there is also a new pilot program that provides cash incentives for tuberculosis testing and treatment with the objective of increasing detection and compliance rates. The design of the tuberculosis (TB) program envisages improving the utilization of TB DOTS services by provision of incentives (Rs. 1000 in two installments) to TB patients that test positive, where the second installment is conditional on completing the treatment. The program is expected to be self-targeted given the much

⁶⁵ This pilot is supported by the World Bank and the Government of Japan (through a grant).

higher prevalence of TB among the poor, and the fact that the program focuses exclusively on patients that report to the public health system. In the pilot phase, the program will target 10 districts and conduct a thorough impact evaluation to assess the feasibility and impact of the program.

Box 3.13: School Meals – International Evidence

School meal programs tend to be very popular with policy makers worldwide and enjoy wide political support, as they are seen to be supportive of health and education status of poor children. School meals, which usually constitute the provision of a meal or snack to children at school, serve a wide variety of purposes. The programs are intended to act as an incentive for attendance at schools, provide nutrition to children and alleviate children's short-term hunger during the day to enhance their attention and learning capacity. School meals can also be considered an income transfer as the program eases the household food budget. The benefits of school meals have to thus be measured against the objective for which they are used and in comparison with other means (e.g., cash transfers) of achieving the same objectives.

In terms of increasing school attendance, several studies have found that school snacks and cash-like transfers increase children's attendance and progress through school in Jamaica (Simeon and Grantham-McGregor, 1989), Honduras (Rogers et al), India (Dreze and Goyal (2003) and the US (Meyers et al, 1989). While some studies have shown an effect of school meals on test performance (for the US, Meyers et al, (1989; for Peru: Pollitt, Jacoby and Cueto, (1995), for Jamaica, Simeon and Grantham-McGregor, (1989), others have found no difference (Rogers et al, 1995 and Dixit, 1994). Many experts have noted that the nutritional impact of school meals is limited because nutritional gains for children occur prior to school going age, but others find that school meal program can alleviate hunger in school going children (Afridi, 2005). Given the wide variety of designs and the contexts in which they operate, it should not be surprising that their effectiveness has been shown to be variable. The cost effectiveness of school meals relative to cash transfers has also been investigated in several studies. Rogers et al (1995); Sanghvi et al, 1995; and Horton, 1992) find that compared with a cash or cash-like (for example, coupons or food stamps) transfer, the cost of delivering a unit of value in a school meal may be several times higher. This is perhaps not surprising. Rogers and Coates (2002) note that school meal programs can face considerable administrative challenges, including logistical problems with food delivery, leakage, food handling, storage, ensuring nutritional content of meals-yet taking into account cultural norms and ensuring adequate training of food preparation experts.

See Rogers and Coates (2002).

3.75 Pakistan's conditional cash/in-kind transfer initiatives are reflective of a growing international trend to include incentives in cash transfer programs for poor beneficiaries to avail health and education services and escape inter-generational poverty. Many countries facing dependency problems in cash transfer programs and the need to break the inter-generational cycle of poverty have provided incentives in their income support programs for recipient families to send their children to health and education programs. The impact of these programs—called conditional cash transfers (or CCTs) has been very positive, with measurable increases in enrollment and nutritional status of children (Box 3.11).

Challenges for Human Capital Access Programs

3.76 As positive as it is to see numerous conditional cash and in-kind transfer initiatives flourishing in various areas of the country, it is important that experimentation leads to overall consolidation rather than fragmentation of cash support programs. Assessments of ongoing initiatives must pay attention to the extent to which these can be successfully scaled up and integrated as part of the main income transfer programs, e.g., Bait-ul-Mal, to improve living standards among the target groups. Similarly, the need for expansion of Tawana needs to be assessed relative to other potentially more cost-

effective programs for improving enrollment and nutrition and reducing hunger of children. As noted above, experience from other countries indicates that a more coordinated approach on targeting and conditioning of cash transfers, given limited fiscal resources and administrative capacity, could be a more efficient way of meeting program objectives.

C. Programs for Coping with Aggregate shocks

3.77 Most of the discussion presented in Chapter 2 revolved around the idea that both poor and non-poor households are subject to aggregate and idiosyncratic shocks and that the consequences of these shocks in terms of lost income and assets can be dire. Although households have developed informal mechanisms to cope with these shocks, the discussion has also made it clear that these are often insufficient and can even cause more harm than good in the long-term. As a result we concluded that there was significant space for government intervention in the area. While income support and basic services programs could protect households from falling into poverty as a result of a shock, these programs (other than workfare) are not ideally equipped to expand in times of natural disasters or aggregate shocks. In this section we examine existing programs specifically designed to address aggregate risks, particularly those associated with changes in agricultural prices (particularly the price of wheat) and those associated with natural disasters.

1. Coping with agricultural price shocks

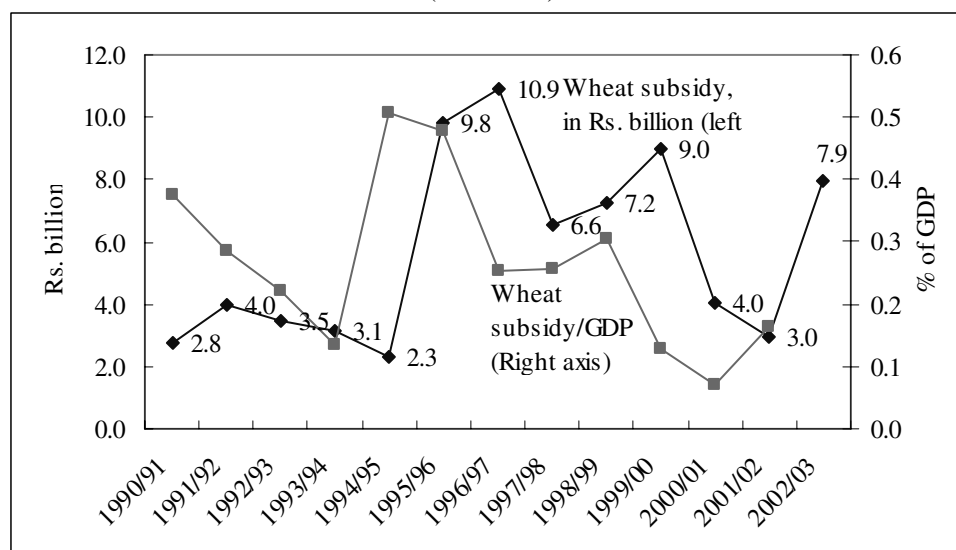
3.78 **The government intervenes heavily in the wheat market with the understanding that wheat is a major staple for Pakistani households and, consequently, changes in wheat prices directly impact welfare, particularly of poor consumers and producers.** Government interventions take various forms, the most important of which is the purchase of wheat from producers at guaranteed minimum prices during the harvest time to sell it to consumers at guaranteed maximum prices during the second part of the season. Grain stocks are held by provincial food departments and by the Pakistan Agricultural and Service Corporation (PASSCO). Stocks held by the former are sold to flourmills at pre-determined prices negotiated between the mills and the government. A suggested sale price for flour is also negotiated. Stocks held by the latter are used for distribution to the armed forces, Northern Areas and AJK, as well as for transfers to provincial food departments (mainly NWFP, Balochistan and Sindh). In recent years, government domestic procurement of wheat by various agencies has averaged 4 million tons of grain, corresponding to 20 percent of national production and about half of marketed grain. The government also sells Atta flour, and other essential commodities at government utility stores located around the country, at fixed prices that are approximately 5 to 10 percent lower than market retail price.⁶⁶

3.79 **Since resell prices are not high enough to cover payments to producers and for storage and handling costs, the government incurs significant fiscal expenses. The system also introduces market distortions.** Over the last 10 years, annual wheat subsidy expenditures have averaged around Rs. 6.8 billion, with the subsidy fluctuating from 0.1 to 0.5 percent of GDP (Figure 3.11). This is much higher than the safety net budget and the total public sector development program for the health division (2004/2005). About one-third of the total subsidy accrues to millers, to cover the difference between the guaranteed purchase and resale prices, and the other two-thirds finance the relative inefficient government

⁶⁶ See Dorosh (2005), from which this section is drawn, for a more complete discussion of the issue. There are currently about 500 utility stores and 12 warehouses with a capacity to sell up to 50,000 metric tons of Atta flour a month, although actual sales are about half this amount.

grain procurement and handling procedures.⁶⁷ Aside from fiscal costs, there are major economic costs of the system. For example, domestic procurement efforts, in line with poor harvests in 2004 led the Government of Punjab to impose movement restrictions on wheat. However, grain still flowed despite movement constraints though with increased costs for unofficial payments to officials, raising prices to millers by about 4 percent.

Figure 3.11: Fiscal cost of wheat subsidy
(Rs. billion)



Source: Dorosh (2004)

3.80 In addition to its high fiscal costs, **the program suffers from other serious problems, including creating distortions in wheat markets and its failure to benefit the poor.** Flour market prices are generally higher than the recommended government price, suggesting that prices are largely determined by overall demand and supply. Since government-subsidized wheat supplies are insufficient to serve total demand, the question then arises as to who benefits from the program in the presence of rationing. Although more in depth analysis is needed, preliminary evidence seems to suggest that the current system favors millers and the non-poor. Subsidies are given through millers and utility stores, so that only those consumers that purchase flour from these outlets benefit. Moreover per-capita wheat consumption increases with income, likely rendering the subsidy regressive (to the extent it has any impact on consumer prices).

3.81 **The high fiscal costs and poor targeting of food subsidies have led several countries to move to targeted subsidies, cash or in kind transfers.** Bangladesh moved from a food subsidies to food for work and finally to a cash for education program. The program has had a major impact on girls' secondary school enrollment (World Bank, 2005c). Similarly, Jamaica and Chile moved from food subsidies to self-targeted food subsidies via food stamps and provision of food supplements at health clinics, respectively. Tunisia has also moved to a targeted subsidies program, with subsidies only applying to inferior quality foods that are consumed by the poor, with significant improvement in targeting outcomes (Tuck and Lindert, 1996). Jordan eliminated food subsidies after improving the administrative and institutional capacity for targeting cash transfers (World Bank, 2005e). Pakistan might

⁶⁷ For example, the total subsidy from 2001/02 to 2003/04 was Rs. 13.6 billion; about 33 percent of this accrued to millers through purchases of government wheat at below-market prices. Note that since market prices and quality of grain vary across markets, these calculations are only rough approximations of the breakdown of the subsidies.

also consider moving away from costly and potentially untargeted subsidies toward more targeted cash transfer programs (see discussion in chapter 4).

2. Coping with natural and other disasters

3.82 Pakistan lacks a comprehensive system to deal with natural and other disasters and, as a result, government-led relief efforts often fail to provide assistance in a timely manner. This was the case after the earthquake that struck Northern Pakistan on October 8, 2005. Since no safety net structure existed that could be rolled out quickly, interventions had to be designed from scratch. An initial response in cash transfers came from Bait-ul-Mal, which quickly commenced distributing a cash transfer. This assistance was later discontinued awaiting a comprehensive assessment of needs and levels of assistance. The package that was subsequently designed provided far more generous benefits than the initial Bait-ul-Mal disbursements. The final relief package combined short-term income support with long-term aid for reconstruction. Short-term support consisted of in cash payments to affected households. The amount of these payments varied with households' circumstances: Rs. 175,000 (in several installments) for those that had lost their house, conditional on rebuilding the house to seismic resistant standards; plus Rs. 100,000 for those that had lost at least one family member as a consequence of the earthquake (with smaller compensation for injury ranging from Rs. 15-50,000); plus monthly livelihood grants of Rs. 3,000 for 250,000 vulnerable households for six months (see Box 3.14).

Box 3.14: Responding to the Earthquake of October 8, 2005

The government and donors responded to the devastating earthquake with comprehensive assistance for relief and rehabilitation. In the immediate aftermath of the disaster focus was on delivering in-kind emergency assistance such as food, blankets, tents and roofing sheets, followed later by a package of financial assistance to the affected households comprising the following elements:

Housing. The government's owner-driven housing reconstruction program aims to reconstruct the damaged houses to seismic resistant standards. By November 2006, the program had completed detailed housing damage assessments of 600,000 houses, signed MoUs with 528,000 owners, and begun disbursing housing reconstruction grants of Rs. 175,000 per house unit in four tranches to owners completely destroyed houses. The disbursement of the tranches is under way and is contingent on the owners rebuilding their house using specified, seismically resistant designs. Partially damaged houses are eligible for restoration and strengthening grants of Rs. 75,000 per housing unit disbursed in one tranche.

Payments for death and injury. Each family that suffered a death of a next of kin received Rs. 100,000 (families who suffered multiple deaths also got Rs. 100,000). Compensation for injuries ranged from Rs. 15,000 to 50,000, with the highest payments going to amputees. **Cash transfers.** The government is in the process of providing cash grants to a targeted group of the most vulnerable households among the earthquake-affected population. The assistance comprises of six monthly grants of Rs. 3,000 per household, to 250,000 households. This assistance aims to provide short-term relief and stimulate economic activity and small businesses. Households that report housing damage, contain no senior government employee (at or above grade 17), and are either headed by women not currently married, or contain a disabled member, or contain five or more children (incl. orphans) are eligible. The total cost for this program is Rs. 5 billion. Other forms of livelihood support such as microfinance, business grants, and workfare may also be considered.

Several lessons can be drawn from the earthquake response. There is a high need for assistance in the wake of major aggregate shocks and political support for such assistance. Assistance in the form of cash is appropriate and feasible. Emergency assistance can be delivered faster and better if investments in targeting and delivery mechanisms have been made before the disaster strikes. An unresolved question is how much the political support for disaster assistance translates into support for assistance toward idiosyncratic shocks and chronic poverty.

3.83 **The Government also initiated support for the care of individuals who suffered from disability as a result of the earthquake.** Aside from cash transfers, the earthquake demonstrated the need for social welfare and care services for individuals who suffered in the earthquake: disabled, widows and orphans. The Government stepped up its efforts to help these vulnerable groups after the disaster. The Government has developed the National Strategy and Plan of Action for Vulnerable Populations in Earthquake Affected Areas and the Earthquake Reconstruction and Rehabilitation Agency has approved its draft social protection strategy. Among other things, the strategy envisages continued cash transfers to the most vulnerable (e.g., widows and others without economic support) and community-based rehabilitation (CBR) support to the disabled. The Government is initiating a program of CBR anchored in four resource and information centers for persons with disabilities in the earthquake-affected areas. These centers will help coordinate a program of expanded outreach of rehabilitation services to persons with disabilities, working also with the Pakistan Poverty Alleviation Fund.

Challenges ahead for risk coping in natural disasters

3.84 **As agricultural and natural disaster shocks account for 10 percent of all shocks reported by households in the PSNS, the current safety net program mix leaves a significant amount of risk uncovered.** There is very low coverage and support provided by safety net programs primarily designed to address chronic poverty. The wheat subsidy program most likely fails to benefit those who need it most while taxing away significant amounts of resources. On the other hand, no comprehensive system is in place to allow the government to respond to natural and other disasters in a timely and effective manner, leaving affected households to deal with the event's immediate aftermath on their own. It is also unlikely that similar packages to the one provided to earthquake victims will be made available to those affected by future disasters.

3.85 **The lack of an effective safety net to cope with aggregate agricultural and natural disaster risks is at best inadequate, and a more comprehensive approach to helping households cope with disasters is required.** As noted above, safety net programs as currently designed are not particularly effective in dealing with shocks. They are not designed to expand and contract quickly or to deploy resources fast enough to affected populations. Strengthening cash transfer and social welfare and care service programs overall and providing them with some flexibility to expand in times of natural disasters will be important. However, as discussed in the previous section (and Box 3.10) many countries in the region and worldwide have turned to well designed self-targeted workfare programs to provide fast relief in case of natural disasters and more generally as a way to provide temporary employment opportunities in case of income shocks. We examine the potential for a workfare program for Pakistan in Chapter 4.

IV. PROVIDING INSURANCE THROUGH SOCIAL SECURITY

3.86 **While safety nets can address poverty, social security programs, e.g., insurance and long-term savings can prevent households from becoming poor in the first place.** As discussed in Chapter 2, social security programs help *mitigate risks* and hence smooth consumption over time. They provide ex-ante protection to individuals against unpredictable idiosyncratic (or individual specific shocks) such as health or economic shocks, against age-related shocks such as retirement or death, or against shocks that undermine an individual's capacity to provide for herself, such as disability.^{68 69}

⁶⁸ Insurance also provides protection against aggregate e.g., against floods and crop losses though the discussion of these is outside the scope of this paper.

⁶⁹ In most South Asian countries, only the formal sector has access to publicly provided pensions (or insurance against longevity, disability and survivor-both civil service and the private sector. Civil service pensions often have two parts: one defined benefit (pension is calculated formulaically based on among other, years of service, last

3.87 **Although given their limited saving capacity the poor stand to benefit relatively more from having access to social security than the non-poor, social security programs tend to disproportionately cover the latter due to the strong link between coverage and access to formal employment.** As in other South Asian (and low income) countries, Pakistani formal sector workers have access to pensions, to health, sickness and maternity insurance, and even to unemployment insurance, while informal sector workers are completely unprotected. Micro-insurance coverage is negligible. Aside from a pilot scheme in NWFP, the country does not have a social pension program. In this section we briefly describe the existing social security programs and identify the challenges ahead, particularly in terms of expanding coverage in a low income setting.

Formal Sector

3.88 **Article 38 of Pakistan’s constitution explicitly refers to compulsory social insurance. Yet coverage in such programs is limited to the minority of better-off workers employed in the formal sector** (30 percent of the non-agricultural labor force in 2003/04). Civil service pensions for the public sector are the most important social security scheme, providing benefits to a relative elitist group of workers against old age, disability and survivorship. Outside the public sector, the risks covered are mostly limited to old age, disability, and survivor pensions for formal sector workers—also not among the poorest—although some workers also have access to health and maternity benefits. The two main schemes are discussed below.

Civil service pension scheme

3.89 In terms of spending and coverage, **the civil service pension scheme is by far the largest program. Pensions are financed directly from the budget in the same way as salaries, and can indeed be seen as deferred payment.** Together federal and provincial civil servants comprise 1.97 million workers. There are no contributions nor is any fund accumulated to offset the liability. The size of this unfunded liability (or ‘pension debt’) is large when compared to published public debt figures. But its exact magnitude is difficult to ascertain and is not reported in the fiscal accounts.

3.90 **Benefit levels are relatively high for civil servants.** Individual benefit levels, covering death, disability and old age are determined by a formula. The calculation takes into account final basic wage, dearness allowance and the length of service. Other allowances are not considered in the calculation. Since 2001, the replacement rate at retirement (i.e., the ratio of pension to pensionable earnings) is capped at 70 percent (of the basic wage in the final year) for a worker with 30 years of service. This implies an accrual rate of 2.33 percent per annum. Up to 40 percent of the pension can be commuted and taken as a lump sum. The remainder is paid as an annuity until death. A survivor’s benefit of half the pension of the deceased is paid. Disability benefits are also provided. The annuity is not indexed, but increased on a discretionary basis. Employees of state-owned enterprises are covered by separate DB schemes that are similar (and sometimes more generous) to those for civil servants.

wage, etc.) and generally financed by government contributions and the other defined contributions (or benefit is the return on the amount contributed to a fund). Private sector pensions are generally defined contribution based, though funds are publicly managed. In higher income countries, social security programs are mandatory, funded out of payroll taxes, and provide a minimum benefit against shocks. They are mandatory because it is assumed that individuals if left to themselves are myopic and do not save adequately against risks. Most often social security programs are pay as you go (with current taxpayers financing current pension benefits) and publicly managed, but an aging population and poor resource management is leading in some countries to defined contribution of (some or part of the pensions) and private management of fund assets (e.g., Chile, Poland).

3.91 **There is substantial early retirement in the scheme.** The normal retirement age is 60, subject to having completed 10 years of service. If the worker leaves service prior to 10 years, a gratuity (lump sum) is paid. Importantly, retirement is possible with just 25 years of service regardless of age⁷⁰ There is no adjustment to the level of the pension to take account of the fact that its ultimate value and cost are higher the earlier the pension is drawn. In addition to the DB scheme, workers are required to contribute 3 to 8 percent of basic salary to the Government Provident Fund (GPF – the contribution rate is higher for higher earners.) The contributions are recorded in the government accounts, but are not invested. The GoP determines the interest rate each year. The role of the GPF in providing for retirement is limited by withdrawals for various purposes before retirement.

Table 3.13: Overview of Private Sector Social Security Programs

Name of scheme	Source of funding	Target group of beneficiaries	Implementing agency	Type of benefits provided	Issues
Workers Welfare Fund (WWF)	2% of the taxable income of the enterprise	Workers of registered organizations earning less than Rs. 5,000 per month are eligible	Projects are planned and implemented by Provincial Workers Welfare Board (WWB)	Construction of houses, establishing schools and health facilities, bicycles, sewing machines and fans for workers, provide grants for education and marriage	Allocations for WWB only about half of collections; duplicate activities; workers in the companies that contribute the most, benefit the least since their salaries generally exceed the Rs. 5000 monthly ceiling.
Education Cess	Rs. 100 per worker per year	Workers in establishments with more than 10 workers and earning below Rs 3000 per month	Special schools run by WWF	Free schooling of two children of each eligible worker	Most children enrolled are from families that do not work in cess-paying enterprises; duplicates regular government schools
Provincial social security (Employees Social Security Institutions)	Employers contribute 7% of the wage of workers earning up to Rs. 5,000 per month	All workers of an enterprise registered with an ESSI, earning less than Rs. 5,000 per month.	Employees Social Security Institutions (ESSIs), run by the provinces	Insurance against natural death, disability, and injury; medical care, cash benefits, and survivors' pensions covered. Health care provided in specially-run hospitals.	Firms may underreport the number of their employees, despite allegedly intrusive inspections by ESSI staff. High administrative costs and poor quality of services delivered; duplication of health facilities
Group insurance	Premia paid by employers			Employers are required to provide life insurance by covering each employee for a	

⁷⁰ Armed forces and frontier guards are eligible for the pension after only 18 years of service and have a higher accrual rate.

Name of scheme	Source of funding	Target group of beneficiaries	Implementing agency	Type of benefits provided	Issues
Employees Old age Benefit (EOBI)	6 % of minimum wage (Rs. 3000 as of July 2005).	Workers in establishments with 10 workers or more (defense police, railway, local bodies, banks and the carpet industry are exempted)	EOBI is headed by a Board which works under the guidance of the federal Government	minimum of Rs. 200,000 Old age pensions of 2% of the wage in the final year, with a minimum pension of Rs. 1000 per month, payable for life to males of 60 years and above and females age 55 and above, with a minimum of 15 years of service	Financially unsustainable (contributions will not cover promised benefits); Very high administrative costs (35% of benefits paid out); investment regime
Workers Profit Participation Fund (WPPF)	5% of the annual profit tax of the enterprise			Funds distributed among the workers of the company up to a maximum of Rs. 5,000 per worker	
10C Bonus	All companies declaring a profit are required to pay bonus			Bonus equal to a minimum of one month's salary	
Gratuity			Firms themselves	30 days wages for each completed year of service in excess of 6 months	

3.92 **The scheme just described applies to civil servants at both the federal and provincial level, and has the largest coverage of any social insurance plan in the country.** The armed forces and frontier guards are eligible for the pension after only 18 years of service and have a higher accrual rate. Employees of state-owned enterprises are covered by separate DB schemes that are similar (and sometimes more generous) to those for civil servants. Together, federal and provincial civil servants comprise 1.97 million workers.

Social security in the private sector

3.93 **EObI is a compulsory federal social insurance scheme for private sector workers.** The coverage for the EObI scheme is shown in Table 3.15 below. The table also shows some disparity across regions with EObI coverage in Balochistan only around one percent.

3.94 **The EObI pays rather limited pensions to formal, private sector workers.** Its contribution rate for employers was increased from 5 to 6 percent of the minimum wage (currently Rs. 3,000 per month) in July 2005 and is legally mandated for firms with at least 10 employees. There is an employee contribution of 1 percent of the minimum wage. Men aged 60 and women aged 55 with at least 15 years of contributions are eligible for benefits. The pension is not indexed after retirement but the minimum, currently Rs. 1000 per month, has been increased sporadically over the years. An estimated 1.5 million were actively contributing to the scheme in recent years, although the reported number of members is much higher reflecting movement in and out of the formal labor market and other factors.

3.95 **The pension provided for EObI is generally much lower than that provided by the civil service pension scheme.** Survey data reveal that the average pension in the civil service was approximately 45 percent higher than the EObI. Combined with the relative immaturity of the EObI scheme and a demographically older civil service, expenditures on EObI pensions came to only around five percent of spending for combined provincial and federal civil service pensions. The fraction would be even smaller if military pensions were counted.

3.96 **This disparity between public and private sector pensions is exacerbated by the striking real decline in EObI pensions over time due to lack of indexation.** Between 1988 and 2000, the minimum pension declined by half in real terms and remains lower even after the most recent increase.

Table 3.14: Financing of Social Security

Structure of levies mandated for private formal sector employers		
Tax on profits	Tax on payroll	Tax on number of workers
WWF (2%)	EObI (5%)	Group insurance
WPPF (5%)	ESSI (7%)	Education access (Rs. 100 per year)
	Gratuity (implicitly 8.3%) ⁷¹	
	10C bonus (implicitly 8.3%, if there is a profit)	
<i>Total 7% of profits</i>	<i>Total 28.7% of wage bill</i>	

Note: Table shows the statutory costs. De facto costs are lower because of evasion.

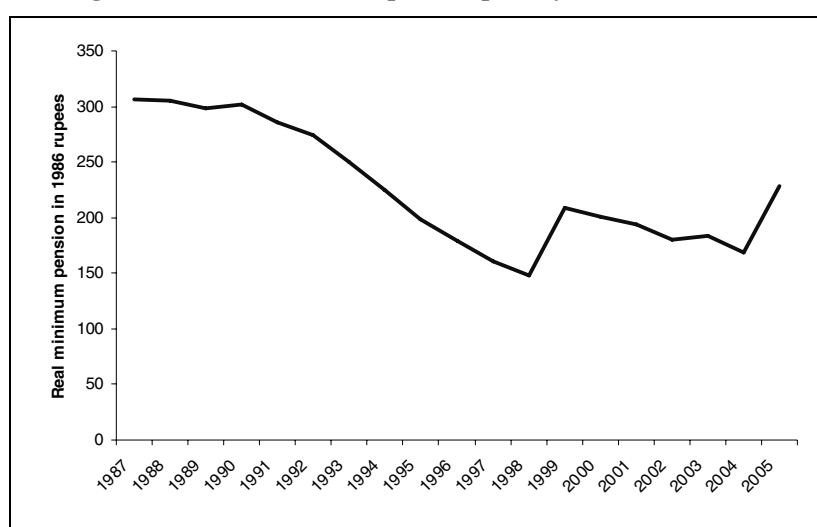
3.97 **Apart from pensions, formal private sector workers in Pakistan are covered by a patchwork of social programs and mandated benefits** The rules and financing for social security programs, as well as a number of benefits that must be provided by larger private sector formal sector employers, are summarized in Tables 3.13 and 3.14. In the private sector, coverage is generally limited to salaried workers in larger firms. Government mandates that these firms provide certain forms of non-wage benefits directly and levies charges used to finance three separate types of funds. Two of these—the

⁷¹ Gratuity is one month salary for each year of service, corresponding to an implicit levy of 1/12 of the wage cost, or 8.3%.

Workers' Welfare Fund (WWF) and the Provincial Social Security (ESSI) scheme—are managed at the provincial level

3.98 Provincial social security programs have more restricted coverage than the civil service and EOBI schemes, but their benefit levels are not well known. Levies on employers are used to finance the Workers' Welfare Fund (WWF) and the Provincial Social Security (ESSI) scheme, both administered at the provincial level. The WWF provides a wide range of benefits ranging from housing to dowry payments and maternity benefits, but covers only 600 companies. The ESSI provides health services and covers about 850,000 workers and their families through its own facilities. Additional employer mandates include an education cess (used to finance education for up to two children),⁷² mandated bonuses, group life insurance, profit-sharing schemes and severance payments (gratuities). Firms offering provident funds are exempted from the gratuity mandate, although a few firms offer both. Little is known about the application of these mandates or whether they provide significant benefits to workers.

Figure 3.12: Real minimum pension paid by EOBI, 1987-2005



Source: Aries Group et al., (2001); staff calculations.

Table 3.15: Coverage of EOBI, 2005

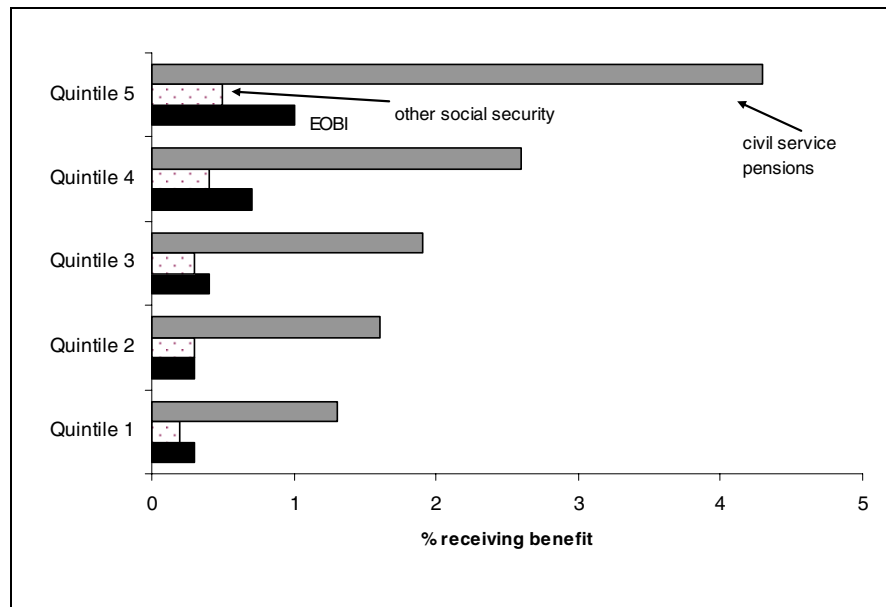
Province	Members	Contributors*	Labor force	Members/ labor force (in %)	Contributors/ labor force (in %)
Punjab	1,344,488	876,936	25,800,000	5.2	3.4
Sindh	766,583	500,000	9,790,000	7.8	5.1
NWFP	155,354	101,329	4,410,000	3.5	2.3
Balochistan	33,322	21,734	1,750,000	1.9	1.2
Total	2,299,747	1,500,000	41,750,000	5.5	3.6

Source: EOBI; Labor Force Survey 2003/04. Notes: Labor force is for 2003/04.

*Contributors are estimated based on ratio of total contributors to members. The latter refers to anyone with a contribution record since the scheme began in 1976.

⁷² Eliminated in Punjab recently.

Figure 3.13: Incidence of different social security benefits by quintile



Source: Staff estimates based on PIHS 2001/02.

Informal sector

3.99 To our knowledge there are currently no major schemes providing pensions to the informal sector in Pakistan. However, some programs are under development:

- For example, *the rural support programs have recently linked up with Adamjee Insurance to provide hospitalization insurance to members of the community organizations they work with.* So far, about 130,000 members have signed up for a program that charges an annual premium of about \$4 for hospitalization coverage with a cap of about \$400. Given the devastating impact of health shocks in the country, it will be useful to follow the implementation of this scheme and evaluate its experience.
- *The NWFP has also initiated a cash transfer to the elderly (often called social pension) in selected districts, with a view to expanding the program to the province as a whole.* Social pension schemes do exist in neighboring countries—e.g., Nepal (targeted to all elderly above 75) and India (targeted to the poor) and also in many countries around the world. However, these schemes can be very costly, depending on the benefit and age cut offs employed. Effective implementation of social pensions has similar requirements as other cash transfer programs, e.g., investment in record keeping and benefit delivery systems. The need for social pensions should also be evaluated in light of competing social assistance needs of other poor groups.

Challenges ahead for social security

3.100 Low coverage of social security schemes is a key challenge for addressing risk and vulnerability of the population. However, the financial sustainability of schemes, and improvements in administration will be required before coverage can be expanded. Thus, the three key challenges discussed below – coverage expansion, administration and recordkeeping and sustainable financing – are interlinked. These are discussed in turn. Modes of expanding coverage to the informal sector, e.g., via micro-insurance and social pensions (cash transfers to the elderly) are discussed in chapter 4.

Low coverage

3.101 **The most salient policy issue in the area of social security is the lack of coverage of the existing schemes, especially the most extensive private sector program administered by the EOBI.** Combined with civil servants, total pension coverage would reach about 8.4 percent of the labor force. With less than one in ten workers in Pakistan covered by social security schemes, it is not surprising that expansion of coverage is a high priority. The EOBI, for example, has made this one of its key objectives in its 2004 Institutional Strategy.

3.102 **The limited coverage tends to reach better off workers.** Those that did receive pension income tended to be in the higher income quintiles as shown in Figure 3.13. This is not surprising given the nature of the mandate – larger firms – and the fact that these are insurance rather than transfers schemes. Nevertheless, it does suggest that even a dramatic expansion of coverage will not do much in terms of insuring workers in the lower part of the income distribution. This will require separate solutions (see next section).

3.103 **Low coverage is a pattern observed in low income countries across the world.**⁷³ Part of the reason is that not all workers are mandated to participate. Agricultural workers, for example, are not included in either the EOBI, WWF or ESSI schemes. Of the remainder of the labor force, about 30 percent are public sector workers covered under a different pension system. Nevertheless, even after excluding informal private sector workers this implies that as many as half of the eligible employees are not contributing to EOBI. Extending legal mandates, such as the proposal to lower the required number of employees at a firm that should participate, are unlikely to result in significant coverage expansion.

Improving administration and recordkeeping

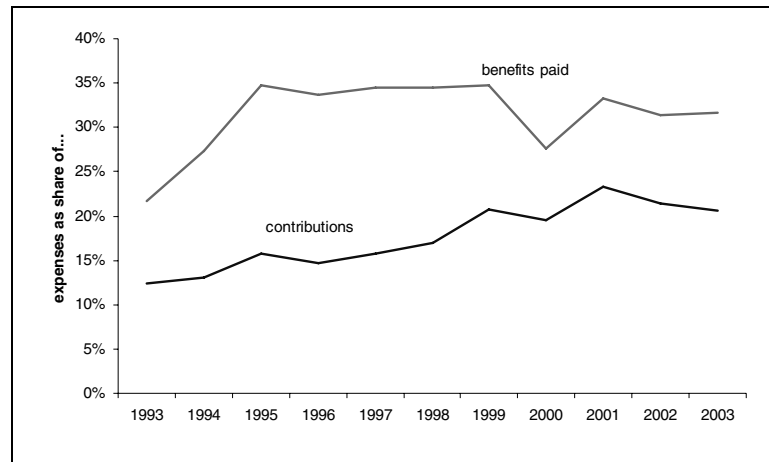
3.104 **Administration and recordkeeping affect system coverage as well as performance.** Poor service in the form of delays, lost records or even outright corruption inevitably lead potential members and employers to avoid contributing to these schemes when possible. Conversely, weak monitoring and supervision allows greater evasion to take place. In this section we focus on EOBI due to the lack of information available for WWF and ESSI. The latter, in particular, due to its direct financing of health infrastructure, would require a separate analysis. The common denominator of all three schemes however, is that no independent monitoring takes place of what are essentially public monopolies.

3.105 **In the EOBI, there are concerns about efficiency in administration.** The collection of contributions and payment of benefits operate through the network of bank branches. At the time of contribution payment, employers submit special payment declaration that facilitates identification of payment source. The same document provides information on total number of employees covered by the payment (so EOBI can assess the total number of active and insured individuals). Details of the employees, however, get submitted on a separate annual report. There are significant delays and lack of compliance with the reporting requirements. The benefit payment system relies on banks playing a key role in keeping records of eligible beneficiaries.

3.106 **Operational costs have not fallen over time relative to standard comparators.** With only a very small fragment of labor force being covered by the scheme, operational cost of the EOBI run at least 20 percent of the collected contributions and almost one third of benefit payments as shown in Figure 3.14. Despite growing assets, the ratio of expenses to assets has remained flat at about 0.8 percent. While it is difficult to determine when administrative costs are excessive in public pension schemes, the current ratios clearly reduce the long term sustainability of the scheme (see next section below).

⁷³ See Palacios and Pallares (2000).

Figure 3.14: Administrative costs as share of benefits and contributions in EOBI, 1993-2003



Source: EOBI.

3.107 **There appears to be considerable gaps in information regarding workers covered by the scheme.** This is due to several factors: First, the institution is struggling to maintain and consolidate several legacy databases. Second, many employers, while making required payments, fail to submit individual payroll reports. In part, this has been attributed to lack of enforcement powers, e.g., there is no penalty for no/late reporting. This leads to the situation where at the time of a benefit claim, it is often very difficult to assess individual eligibility. The benefit claim process typically involves verification of records with employers, and reportedly may be lengthy and not sufficiently based on evidence.

3.108 **Looking beyond EOBI, the current system is highly fragmented resulting in duplication of costs.** Both ESSI and EOBI offer disability and survivors' pensions, for example. There is overlap in the coverage and lack of harmonization in administrative procedures. Some schemes offer education benefits and special health care, duplicating this provision with health and education services. This duplication raises costs of delivering services, and increased costs of participation for employers, potentially increasing evasion.

Table 3.16: Number of beneficiaries receiving cash benefits, ESSI and EOBI, 2004

Benefit	ESSI	EOBI
Sickness Benefit	35,310	n.a.
Maternity Benefit	134	n.a.
IDDAT Benefit	20	n.a.
Old age pension	n.a.	167,171
Death Grant	1,564	n.a.
Old Age grant	n.a.	6,091
Partial and Total Disablement Pension	5,580	5,877
Survivor's Pension	1,564	67,203
Other Benefits	2,502	n.a.
TOTAL	56,895	246,342

Source: Adapted from GVG (2004).

3.109 **According to federal officials, an effort is currently being made to consolidate legislation in this area.** While an important first step, ultimately the problem may lie in the lack of oversight in the system and mechanisms for enforcing the legislation. Boards are tripartite in nature, but employer and employee representatives are appointed by government and have little autonomy. International experience

with tripartite and government-controlled boards of monopoly social insurance institutions has shown that there is some need for external oversight. In a few countries, the financial sector regulator provides guidelines on basic governance issues such as reporting practices.

Financial sustainability

3.110 Civil service pension benefits are financed directly from the budget and represent a large, hidden liability. There are no explicit contributions. The unfunded liabilities have recently been estimated by the World Bank to be on the order of 25 percent of GDP, although this estimate is based on very partial data.⁷⁴ The projected expenditures suggest that provincial government pensions will become a heavier burden in the coming two decades as the civil service demographics play out.

3.111 Currently, contribution rates in the schemes covering private sector workers appear to be determined in an arbitrary manner. To our knowledge, no actuarial calculations are available for the provincial programs such as ESSI. In the case of the EOBI, actuarial reports find that long term benefits are not sustainable under current contribution rates. The latest independent actuarial report finds that cash flows become negative in less than two decades.

3.112 Another important aspect of financial management is how reserves are invested. During the last two decades, the EOBI has relied almost exclusively on investment through the National Savings Scheme. The National Savings Scheme was introduced at a point when the Government of Pakistan needed to raise domestic savings in the face of a difficult external environment. Interest rates paid on these accounts were higher than market rates and the EOBI and other institutional investors reaped relatively high returns. From 2001, however, the EOBI was no longer allowed to invest in National Savings Scheme bonds and has been forced to look for alternatives. With over 100 billion rupees in assets at the end of 2005 and most of the portfolio maturing in 2006, the situation has become critical.

3.113 Little information is available on the management of other funds and there is generally a lack of independent oversight. The annual collections of WWF are less than Rs. 1 billion but only a part of the receipts of the WWF are transferred to the Workers Welfare Board (WWB), which implements the program, and more than Rs. 18 billion is held in trust (earning no interest) by the federal Government (54% of the actual collections to date). Investment policy statements and process are not clearly defined and disclosure is lacking. Expenditures of the ESSI were around 1.7 billion rupees of which only 100 million was in the form of cash transfers. Meanwhile, revenues collected totaled more than 2.4 billion rupees yielding a surplus of about 775 million rupees.

3.114 Managing social security reserves, at the provincial or federal level institutions, requires professional asset management, modern accounting standards, and an appropriate investment policy, unencumbered by political interference in investment decisions.⁷⁵ These elements do not appear to be in place in the public institutions that manage funds today.

V. CHALLENGES AHEAD FOR PAKISTAN'S SOCIAL PROTECTION SYSTEM

3.115 In this chapter we have shown that Pakistan's social protection programs comprising safety nets and social security hold significant potential and recent attempts to experiment with more creative program designs and to evaluate program impacts are commendable. However, important constraints in

⁷⁴ See World Bank (2006a).

⁷⁵ See Carmichael and Palacios (2003).

terms of resources, coverage, targeting, fragmentation, and implementation need to be overcome for these programs to have a real impact on poverty and be able to respond to vulnerability.

3.116 Coverage of both safety net and social security programs is extremely low and targeting of safety nets programs is not as good as it could have been if objective targeting instruments were used. The combination of limited aggregate coverage and inadequate targeting significantly undermines the potential impact of already scarce resources on poverty and vulnerability. Lack of poverty and inequality impact is exacerbated by the fact that benefit levels are small and paid irregularly. Finally social protection programs suffer from poor quality of service, deficient information management, and excessive fragmentation, all of which detract from program effectiveness and efficacy.

3.117 More generally limited resources and the lack of a comprehensive framework that holds existing programs together as a system exacerbate some of the problems detected at the program level. Aggregate social protection expenditures are low and biased toward social security, which tends to benefit the non-poor and those with access to formal employment. In addition, despite the high levels of vulnerability documented in Chapter 2, existing safety net programs tend to focus on income support and poverty alleviation rather than on risk coping, so that poor and vulnerable households still have to deal with a significant amount of risk on their own.

3.118 Going forward, the chapter suggests that to address poverty and vulnerability, a key priority for Pakistan will have to create a strong safety net, with flexible instruments to address shocks and with adequate incentives to exit poverty. While reforms are and should be initiated in the social security, and innovations in micro-insurance (particularly health) will be critically important, it will take some time (growth in income and the formal sector, and improvements in financial viability and administrative capacity of the formal sector) to extend social security coverage to the population as a whole.

3.119 The government is aware of these gaps and shortcomings and has already taken initial steps to rectify some of them. Although social protection cannot address all of Pakistan's poverty and vulnerability in the absence of sustained economic growth, job creation, and macro economic stability, it can help ensure that the benefits of growth reach those who need it most through redistribution and risk-pooling. In other words, a well-designed social protection system can help make economic growth more pro-poor. Recent economic progress provides the fiscal space and the opportunity to address some of the issues identified in the chapter. We discuss some options for social protection program design in the following chapter.

CHAPTER 4. AN AGENDA FOR BETTER SOCIAL PROTECTION

I. INTRODUCTION

4.1 Recent economic growth in Pakistan has provided the opportunity and fiscal space to protect the poor and vulnerable in the country. What should be the priorities for the Government of Pakistan in effectively tackling social protection reform? How much would a comprehensive reform package that addresses the most important challenges identified above cost? What would this imply for specific programs? In response to the government's request to evaluate its social protection programs and propose options for improvements, this chapter makes the case for the development of a comprehensive social protection reform agenda that attends to existing vulnerabilities, while being affordable and gradually phased in. In doing so the chapter attempts to present options and stimulate discussion rather than to prescribe a blueprint for reform.

4.2 This chapter is structured as follows: Section II identifies broad areas for reform and discusses the estimated aggregate costs associated with implementing the proposed reform package; Section III then provides details on reforming specific safety net and social security programs along the general lines identified in Section II. Special attention is paid in the case of safety nets to strengthening cash transfer programs and social welfare and care services, and to the introduction of workfare; and finally, Section IV concludes the chapter.

4.3 The main findings of this chapter can be summarized as follows:

- Pakistan could benefit from a social protection reform agenda that helps protect the poor and vulnerable through a combination of existing and new programs, within the fiscal resources available to the country. Given Pakistan's low income the focus of the program is on creating a more productive social protection system, one that not only helps the poor cope with poverty, but also, by promoting exit and better risk management and helping cushion the social impact of reform, helps the poor participate in, and contribute to, economic growth (World Bank, 2005j).
- This strategy could support the construction of a more effective social protection system around two pillars, with activities that would need to be phased in over time: (i) *Developing 'productive' safety nets to help individuals cope with poverty and risk and promote exit from poverty* through (a) strengthening basic income support and services, with a focus strengthening cash transfer programs potentially linked to human development outcomes, and (ii) *Providing effective social security to reduce individuals' risk of falling into poverty* by (a) improving the functioning of the formal social security system (pensions, disability survivor) and, given that extending social security coverage is a long term proposition, and (b) piloting innovative approaches to mitigate risk in the informal sector (e.g., community health insurance).⁷⁶

⁷⁶ A workfare program is also a type of informal unemployment insurance program.

- *These efforts should be complemented by measures aimed at reducing or eliminating other smaller (and often ineffective) initiatives and consolidating fragmented new initiatives to curtail the overall fragmentation of the social protection system.*
- *Expanding coverage of safety net programs through better targeting and moving away from untargeted subsidies, and over the long term releasing resources from non-poor social security spending, by increasing its links to individual contributions.*

II. TOWARD A COMPREHENSIVE SOCIAL PROTECTION SYSTEM

4.4 **As evident in its Poverty Reduction Strategy, the Government of Pakistan is aware of the need to protect the poor and vulnerable through developing a more comprehensive approach to social protection.** This approach is an opportunity to establish priorities and goals for the social protection system as a whole and for specific programs to better articulate them around common guiding principles. Considering social protection as a system rather than a collection of different programs would allow the government to curtail fragmentation, improve the quality of social protection spending, and have higher impact. A strategy would be an opportunity to clarify the role and responsibilities of various social protection institutions.

4.5 **In moving forward, a social protection system can be organized around two pillars:**

- ***Productive safety nets to help individuals cope and escape poverty, with the flexibility to respond to natural disasters.*** This involves (a) reforming and strengthening basic income/cash support, and linking it, based on pilot results, to improving human capital outcomes of the poor; and (b) gearing the system to respond more effectively to natural disasters and other aggregate shocks (e.g., droughts, earthquakes). Piloting and evaluating innovative and affordable models to complement this basic safety net (e.g., workfare, and social welfare and care services) could be considered to strengthen basic income support, with scaling up pending fiscal resources and administrative capacity.
- ***Effective social security to reduce individual's risk of falling into poverty:*** This much longer term effort could focus on (a) strengthening the formal social security system (public and private) through contributory schemes that offer consumption smoothing against individual risks (health, sickness, disability); and (b) given potentially high exposure to individual risks, piloting and evaluating innovative approaches to extend insurance coverage to the informal sector (e.g., social pensions or community based insurance), with scaling up based on administrative resources and fiscal capacity

4.6 **Gradual, as opposed to simultaneous implementation of various reforms is desirable, given fiscal and administrative constraints.** As expansion of social security to address individual risks will take time to unfold, a well-targeted and administered safety net is likely to be the main social protection instrument for Pakistan in the near term.

4.7 **Given fiscal constraints, the expansion of coverage could be financed through better targeting of existing programs, phasing out untargeted programs and program consolidation.** Initial estimates show that a package of reforms, such as the one noted below, could significantly increase total annual expenditures on safety nets,⁷⁷ which may not be fiscally or administrative feasible in the near future. Thus, as a first measure, increasing coverage will mean better targeting current programs, and

⁷⁷ Appendix 4 provides potential fiscal costs of safety net programs under particular assumptions of coverage and benefit levels.

reducing fragmentation and duplication of efforts across agencies (e.g., various stipend, training programs embodied in the cash transfer system) and reducing untargeted programs (e.g. wheat subsidies). Increase in coverage over and beyond these resources will need to be phased in as resources and administrative capacity allow. However, the declining share of GDP spent on safety net programs is worrisome and it is therefore welcome that the government is considering how best to ensure adequate yet fiscally affordable spending on safety nets in its draft social protection strategy. Over time, the share of resources to social security programs, largely availed by the non-poor, will also need to be addressed and better linked to individual contributions and any expansion of coverage (including social pensions) in social security will need to be carefully considered against available resources. To pool resources across rich and poor provinces, safety net programs need to be federally financed. Social security pool risk through individual contributions that are calculated on actuarial fairness, safety nets are general revenue financed in order to pool risks across rich and poor regions.

4.8 Improvements in administrative arrangements are needed for better delivery of social protection benefits and services. Without adequate administration, public information, and incentives to promote better governance, even the best designed programs can fail. Better governance of safety nets includes streamlining of benefits, clarifying roles of public actors, facilitating private sector partnerships, strengthening data collection and reporting systems, refining targeting systems, increasing system outreach, strengthening staff and management capacity, and setting up monitoring and evaluation. Better governance of social security would involve strengthening the capacity to forecast and simulate the impact of reforms, modernizing record keeping, and improving management and oversight of funds. Public information will be important for higher program outreach and public relations campaigns could be used to communicate and seek support for reforms.

4.9 Social protection reforms will need leadership and inter-institutional coordination. While several separate agencies run different programs, policy needs to be coordinated to ensure national policy goals are met, synergies reached, and fragmentation avoided. Other countries with a similar challenge have retained their Ministry of Social Welfare or its equivalent in a coordinating role for social assistance and the Ministry of Labor or its equivalent in a similar role for social security. In Pakistan's case, the Ministry of Social Welfare and Special Education would seem a natural choice for overseeing and coordinating safety net reforms, since the minister chairs the Cabinet's social sector committee, but it would need strengthened capacity to design and evaluate policy. Coordination is important. For example, developing and implementing conditional cash transfers calls for coordination between Ministry of Social Welfare, Bait-ul-Mal, Health, and Education. Similarly social security and employment-based programs could be overseen by the Ministry of Labor after consolidating some of the current implementation arrangements that split responsibilities between federal and provincial agencies.

4.10 We now turn to key areas of action for each of the two parts of the system.

Table 4.1: Overview of main programs, target groups, and expected outcomes

Program	Target group	Expected program objective after reform	Priority being addressed
1. Safety Net			
a. Basic Income Support and Services			
<i>Unconditional</i>	<i>Chronic poor</i>	<ul style="list-style-type: none"> • <i>Income support</i> 	<ul style="list-style-type: none"> • <i>Protecting against poverty including from aggregate shocks</i>
Social care services (pilot)	Vulnerable groups (disabled, children, others)	<ul style="list-style-type: none"> • Enhanced welfare of target groups 	<ul style="list-style-type: none"> • Protecting against poverty including from aggregate shocks
b. Promoting Exit			
<i>Transforming unconditional to conditional Transfers</i>	<i>Chronic poor (with children)</i>	<ul style="list-style-type: none"> • <i>Increase Human capital of poor children/mothers</i> 	<ul style="list-style-type: none"> • <i>Promoting exit from poverty</i>
Links to micro finance, skill development	Chronic poor (adults)	<ul style="list-style-type: none"> • Increased access to economic opportunities 	<ul style="list-style-type: none"> • Promoting exit from poverty
c. Addressing Aggregate Shocks			
Workfare (pilot)	Poor or vulnerable households with members of working age	<ul style="list-style-type: none"> • Income support • Lower income volatility 	<ul style="list-style-type: none"> • Promoting risk management
2. Social Security			
a. Formal Social security			
	Formal sector workers (platform for informal workers)	<ul style="list-style-type: none"> • Protection against old-age poverty, disability and survivorship 	<ul style="list-style-type: none"> • Promoting risk management
b. Informal Security (pilot of community based insurance; social pensions)			
	Informal Sector	<ul style="list-style-type: none"> • Protection against health shocks 	<ul style="list-style-type: none"> • Promoting risk management

III. SPECIFIC OPTIONS FOR PROGRAM DESIGN, FINANCING, AND IMPLEMENTATION

4.11 Following the general discussion above, in this section we provide more detail on options for reform within the two broad areas identified above: strengthening safety net programs and improving social security.

A. Developing Productive Safety Nets: Coping with Risks and Promoting Exit from Poverty

4.12 This section discusses options that would help improve the efficiency of the safety net: strengthening the basic income support programs, including provisions for exit; promoting social welfare and care services; and introducing flexibility in the safety net to protect individuals against income shocks through workfare. Needed investments in streamlining programs, administration, and financing are also discussed below.

1. Strengthening Basic Cash transfer/Income Support Programs

4.13 Strengthening the cash transfer system will require attention to expansion in coverage, attention to benefit levels; and improvements in targeting efficiency of programs, within available fiscal resources.

Expansion of coverage

4.14 *The coverage provided by Zakat and Bait-ul-Mal cash transfer programs needs to be expanded if programs are to act as significant poverty alleviation mechanisms.* As noted above, the coverage of both programs is quite low to act as a viable safety net. Coverage expansion at current levels of expenditure could be undertaken partially through improvements in administrative efficiency and focus on core mandates in the two cash transfer programs (e.g., better targeting of cash programs, reduced program fragmentation and overlap). Under assumptions of perfect targeting, current expenditures of Zakat, Bait-ul-Mal, and the wheat subsidy combined could be used to provide coverage to 3.1 million poor households (or 42 percent of the poor and 17.9 percent of the poverty gap—Table 4.2). However, targeting is not perfect even in the best of circumstances. Under assumptions of 20 percent of benefits going to the non-poor, current expenditures of Zakat, Bait-ul-Mal, and the wheat subsidy could provide coverage to 2.5 million poor households and cover one-third of the poor and 14 percent of the poverty gap.

Level of Benefit: Balancing Adequacy, Coverage, and Incentives

Increasing benefit will have to be weighed against work disincentives, fiscal costs and coverage expansion. Program benefit is very low for both programs and some increase in benefit to provide poverty impact is justified. However, increasing benefits for all recipients would need to be weighed against expanding program coverage, which is a more immediate need of both programs. While work disincentives are not likely to be significant given the current low level of benefit, an increase in benefit should take these into account, particularly for poor households, for whom benefits are a larger share of consumption (and wage). There is one caveat. Increases in benefit cannot be envisioned for Zakat, given declining program revenues. Benefit levels should also be coordinated across cash transfer programs and with other safety net programs to ensure equity and incorporate incentives.⁷⁸

Table 4.2: Fiscal resources and the poverty gap

	Zakat	PBM	Wheat subsidy	All three
Revenues/expenditures (million Rs., current)	6291	4100	8000	18391
Scenario 1: Assuming perfect targeting				
Number of poor that could be covered with cash transfers at current benefit levels (million)	1.0	0.7	1.3	3.1
Share of poor that this would cover (assuming perfect targeting)	14.3%	9.3%	18.2%	41.9%
Share of poverty gap this could cover	6.1%	4.0%	7.8%	17.9%
Scenario 2: Assuming 20% of resources leak to the non-poor				
Number of poor that could be covered with cash transfers at current benefit levels (million)	0.8	0.5	1.1	2.5
Share of poor that this would cover (assuming perfect targeting)	11.5%	7.5%	14.6%	33.5%
Share of poverty gap this could cover	4.9%	3.2%	6.2%	14.3%
Memo item: resources required to fill 50% of poverty gap (mill Rs)				51442

4.15 *Cash transfers with low, recurrent, and reliable transfers are preferable over large one-off benefits.* Cash transfers that are smaller in terms of amount of transfer (e.g., Food Support Program of Bait-ul-Mal or guzara of Zakat) appear to be better targeted and governed than larger one-off grants such as Rehabilitation grants (Zakat) and Individual Financial Assistance (Bait-ul-Mal). Larger amounts of transfer have a larger poverty impact but can induce more attempts at benefit capture by the non-poor. Moreover, microfinance with its repayment discipline and repeat loans is arguably better suited for small enterprise development support than one-off grants. Thus, phasing out one-off high benefit programs and

⁷⁸ Best practice in higher income countries with formal economies is to set benefits as a percent of average wage, with maximum safety net benefits lower than minimum wage, which is itself lower than unemployment benefits and minimum pensions.

keeping benefits low, with options discussed above, should help improve governance and targeting of programs.

4.16 *Benefit payment should be made regularly (every few months) and in a timely fashion, to allow households to smooth consumption over the eligibility period.* Benefit adequacy includes the level and the timeliness of benefit payment. As noted in the earlier chapter, aside from low benefits, the delay in granting of benefit and irregularity of payment is noted by recipients as severely limiting the usefulness of the program. Ensuring adequate financing of programs, better payment systems, and improvements in program administration should, inter alia, help improve the timeliness and regularity of benefit.

4.17 *The duration of benefit also needs attention.* Zakat and PBM's effectiveness in terms of both long-term poverty alleviation and adaptability to changing household circumstances within a given budget envelope could be enhanced by defining a program graduation policy. For example, re-checking eligibility periodically (taking households off the books) would help ensure that, within limited fiscal resources, new beneficiaries can be incorporated to program rolls as and when they become eligible. Temporary employment in workfare/public work programs, where they exist, could be closely coordinated with social assistance programs, can also be used as an incentive test and allow screening of household members who are able to work.

Box 4.1: Setting Benefits Levels – Balancing Adequacy and Incentives

One of the key challenges in the design of cash transfer systems is to balance the individual's need for assistance against the adverse effects on the labor supply that may arise from providing transfer payments. How generous should a cash transfer program be?⁷⁹ Social (cash-based) assistance programs in developing countries typically provide benefits that are considerably less than “minimum incomes” and certainly far less than the “minimum standards” requirements established under the ILO Minimum Standards convention (ILO 1952). For example, in China, regular social assistance in rural areas was equal to a quarter to one-third of the poverty line income. In India, a monthly social assistance pension pays 10 percent of the poverty line household income in most states (Jain 1999).

Are these benefits too low? If benefits are very small, then the program may not provide much of a safety net, and it may become quite expensive to administer. In extreme cases, the costs of ensuring compliance may be even greater than the benefits provided to the poor. There are several reasons for lower benefit levels in low income countries:

- *Access to informal income.* Unlike many upper-income countries where an interruption of the employment of a household member implies that the household's earnings will fall significantly, a change in employment status in developing countries may simply mean that the breadwinner has shifted from the formal to the informal sector or from relying mainly on his or her own earnings to relying more on an informal transfer from a family member.
- *Affordability.* Developing countries have much lower tax revenues, limiting their ability to provide generous benefits.
- *Adverse incentive effects.* The more generous the cash transfer program, the more such programs are likely to discourage (or crowd out) private transfers, to encourage individuals to behave in ways that will gain and retain their program eligibility, to discourage thrift and precautionary savings, and to encourage those not covered by the program to try to claim benefits as well. This is especially the case in countries where there is a large near-poor population.

⁷⁹ Benefit generosity is commonly defined in terms of replacement income. This compares cash benefits (either gross or net of tax) to past earnings, the earnings of an average production worker, the minimum wage, or average incomes. Benefit generosity is also expressed in terms of ease of access to benefits, the duration of benefits, the level of in-kind assistance provided in conjunction to cash benefits, the stringency of benefit-retention requirements, and the size of co-funding requirements for public insurance and assistance.

4.18 *Making benefit receipt conditional on beneficiary participation in income enhancing programs can also reduce benefit dependency and promote exit from poverty.* Given the high vulnerability of children and the need to break the intergenerational cycle of poverty, programs can promote access of poor children to health and education programs through conditioning cash transfer receipt on participation in health and education programs, assuming positive evaluation of pilots underway (see below). Over time, the program can also increase access of poor beneficiaries to training/skills programs and microfinance programs to promote exit from poverty.

Increasing Targeting Efficiency: Adoption of an Objective Targeting Instrument

4.19 While some elements of both cash transfer programs show pro-poor targeting performance—particularly the Bait-ul-Mal Food Support Program (see Chapter 3)—the targeting of both programs could be significantly improved. Both programs exhibit significant resource leakage to the non-poor compared to similar programs in other countries. Given that program coverage is already limited due to scarce resources, inefficient targeting can significantly undermine program impact on poverty and inequality.

4.20 *A number of targeting instruments can be considered for Pakistan (see Box 4.2). One option is to develop a proxy means test (PMT).* This method uses a weighted average of characteristics (or categories) to determine household eligibility for benefit. Given its reliance on easily verifiable characteristics of poor rather than their formal income, it is suited to countries with informal economies. If expenditures remain limited for covering the poor across all geographic areas, some form of geographic targeting might be considered in addition to PMT.

4.21 *Initial simulations suggest that proxy means testing could significantly improve programs' targeting outcomes.* Simulations used the PIHS and the Social and Living Standards Measurement Survey 2004/05 (PSLM) nationally representative household surveys to estimate a formula based on a set of verifiable household observables such as housing, demographics, education, occupation, and land holdings. The simulated targeting results were compared to the actual consumption and poverty status of the households. The estimated formula achieves 46 percent leakage and under-coverage for the country as a whole with a cut-off of 20 percent. For a 10 percent cutoff, leakage and under-coverage would be 60 percent. The model does better in urban than in rural areas. More work will need to be done to fully evaluate the adaptability of this approach to the current cash transfer system, including potentially augmentation with other targeting measures.

4.22 *Combining household assessment with geographic targeting can improve accuracy.* Some countries combine household assessment mechanisms with a certain degree of geographic targeting. The international review by Coady, Grosh and Hoddinott (2004) shows that combining multiple types of targeting mechanisms (e.g., PMT with geographic targeting) can yield higher accuracy. Areas with high concentrations or density of poverty can be prioritized for registration (e.g., with the survey-outreach approach) and program expansion.⁸⁰ Community based verification may be also be useful to improve the accuracy of targeting outcomes.

4.23 *Using a transparent targeting procedure would allow the formulation and communication of clear eligibility criteria, the absence of which constitutes a major weakness in both cash transfer programs.* It would also allow transparency in selection of beneficiaries and reducing the discretion of

⁸⁰ Nonetheless, to ensure that the poor in other (non-prioritized) areas also have access to the program – and to promote perceptions of fairness and transparency—anyone should be able to apply to register in the unified household information system at any time via on-demand applications (provided that they are clearly informed that registration does not guarantee benefits).

local officials. All applicants, both those selected and rejected, would be included in the targeting information base allowing for program monitoring and ex-post auditing. This could substantially increase transparency in the selection of beneficiaries and ensuring compliance with program selection criteria.⁸¹

4.24 *Aside from the development of transparent targeting mechanism, there are many details that go into designing and implementing household targeting systems that take time to pilot, design and implement, particularly on a large scale.* Numerous factors need to be considered, including: (a) an appropriate data collection strategy; (b) adequate systems management; (c) the feasibility and potential accuracy of household assessment mechanisms; (d) institutional arrangements; and (e) monitoring and oversight mechanisms to ensure transparency, credibility and control of fraud (See Box 4.6).

⁸¹ While community-based targeting, as used in Zakat, has not led to particularly favorable targeting outcomes, other countries have had success using this method.

Box 4.2: Proxy Means Testing – A promising approach to targeting cash transfers

Targeting cash transfers is complex. The ‘gold standard’ of targeting—using a verified means test (VMT) that determines eligibility based on monetary income—is not feasible in most developing countries. It is costly and requires formal income records. Poorer countries with large informal economies, where income is difficult to observe or verify are not ideally suited to use this targeting method. Instead, developing countries rely on alternatives such as:

- Proxy means test (using a composite formula based on observable household characteristics)
- Categorical targeting (for example, pension to the old, disabled, etc.)
- Geographical targeting (focusing on areas known to be poor)
- Self-targeting through consumption (i.e., tying subsidies to inferior goods) or work requirements (as in public works/workfare, see below)
- Community-based targeting (community members decide on eligibility)
- Or a combination of these methods.

Proxy means testing (PMT) has emerged as a promising approach in countries with large informal labor markets. Proxy means relies on a composite formula based on observable household characteristics (assets, demographics, education, occupation, and housing) to estimate household income, drawing on the statistical relationship between these characteristics and the actual, observed poverty status of households. Households whose estimated income falls below a predetermined threshold are eligible for transfers. To preempt households from misreporting their characteristics, proxy means tests need to be based on characteristics that can be verified fairly easily

Many countries in Latin America, the Caribbean, Eastern Europe, Middle East and Asia are using PMT to improve targeting performance of social transfers (Coady, Grosh, and Hoddinott, 2004; Grosh and Baker, 1995). In a recent study on Latin America and Caribbean countries, Castaneda and Lindert (2005) found that PMT performed well in terms of targeting outcomes, cost efficiency and transparency. PMT systems in LAC have generated targeting incidence outcomes that approximate the impressive record of VMT for a mere fraction of the cost of interviewing and screening for eligibility. Between 80-90 percent of the benefits of proxy-means tested programs in Chile and Mexico are received by the poorest 40 percent of households in those countries. Moreover, the costs of these systems are relatively low (ranging from US\$2.3-8.4 per interview in LAC, or 9-34 percent of comparable interview costs for VMT in the U.S.), and administrative requirements are more manageable for developing countries (particularly middle-income countries). Finally, the PMT systems in several LAC countries also rank fairly high for transparency.

Targeting is not without costs. In Latin America, the cost of proxy means testing varies from US\$2.3 in Colombia to US\$8.4 in Chile (equivalent to Pakistan Rs. 138-504) per visit (costs would likely be lower in Pakistan given lower labor costs). This is because administering a proxy means test requires household information, outreach, verification and monitoring of claims. It also requires political commitment to promote transparency. International experience suggests that institutional and administrative feasibility are amongst the main potential barriers to implementing this targeting method.

2. Incorporating Incentives for Exit: Conditional Cash Transfers

4.25 As noted above, introducing incentives in the main cash transfer programs to promote participation of poor children in health and education programs could help reduce inter-generational transmission of poverty. Monetary incentives in the form of conditional cash transfers have helped promote school enrollment among working children in several countries, leading to a reduction in child labor. The application of this approach to Pakistan will depend on the evaluation results of the many pilots underway in this area. (see Box 4.4). International evidence suggests that implementation of this programs requires attention to the following issues:

4.26 *While child labor can be reduced through cash incentive to promote schooling, it may also need to be complemented by other services.* India has reduced child labor and increased school enrollment

through greater community involvement by increasing awareness-raising and peer pressure on parents that do not send children to school, and the provision of special ‘bridge schools’ that facilitate the transition of working children to the regular school system. While special schools for child workers may be important for ensuring that working children are able to catch up with their cohorts, efforts to mainstream child laborers from special to regular provincial schools at a faster pace would allow a greater number of children to be covered.

4.27 *Supply side constraints?* Will programs work in countries where supply of services is constrained, as in the case of Pakistan? The CCT program may need to be circumscribed to those areas where service provision, e.g., health clinics and schools, exist and where there is limited absenteeism in the system. That said, the program itself may stimulate supply. For example, the Bangladesh stipend program—a conditional cash transfer for education—has increased enrollment (and reduced child labor) in a country where the coverage of schools is not extensive. The program need not be limited to public schools and the modalities of extending school choice will need to be carefully considered.

4.28 *Conditional cash transfers will require inter-ministerial coordination.* To be effective, a CCT program requires coordination between social welfare, health and education ministries. The role of social welfare departments is to identify/target the poor and deliver the transfer, while the Ministries of Education and Health provide services and certify enrollment in programs.

4.29 *Future options.* While current conditional cash transfer pilots are focused on increasing education outcomes of the poor, in the future, as in other countries, these programs could also be evaluated for their potential for providing incentives for children (and pregnant mothers) to participate in health and nutrition programs. What would a CCT component linked to health and nutrition look like? It could be designed to promote a range of desirable health practices by mothers and families, for example, at least 3 prenatal visits during the last two trimesters of pregnancy; ensuring attendance at delivery by a skilled birth attendant; initiation of breastfeeding at birth; appropriate vaccinations and vitamin A provided at required intervals; and dissemination of good health knowledge and practices.

4.30 *Tawana—a part of an overall safety net program?* The program’s core objectives of providing meals as a means of alleviating hunger and increase attendance and learning makes it a type of conditional in kind transfer program. However, any scaling up of this program will require resolving current problems noted earlier. The fiscal costs of expansion of the school meal program will therefore need to be weighed against phasing in of alternative options, e.g., the potential scaling up of conditional cash transfer programs that have similar but complementary objectives.

Box 4.3: Promoting Access to Microfinance

Promoting access to the poor to earning opportunities will require scaling up of microfinance and piloting of approaches to link safety net recipients to microfinance, through investment in training beneficiaries, promoting savings, and initiating small loans.

Strengthening the coverage and efficiency of the microfinance sector can expand income earning opportunities for the poor. Resources channeled into this sector are used for growth in outreach and coverage rather than for subsidizing interest rates. Microfinance programs—if directed to the entrepreneurial poor—can help reduce the overall need for safety nets by enabling the poor to increase their incomes and escape poverty. Thus, more could be done to expand microfinance products to the poor and to women, and very small loans and financial products apart from loans could be used to this end. At the same time, even if expanded, many poor are not able to avail micro-finance programs (because of low literacy, information, etc.). Therefore a complementary approach could be used to link safety net beneficiaries to micro-finance programs. The government could consider this approach, based on a pilot of the Bangladesh VGD model already under way (see Box 3.8).

Increasing the employment prospects of the poor is also important for promoting exit from safety nets. As noted in chapter 3, this approach has been gaining currency worldwide to reduce benefit dependency. An option for doing so might be to promote access of poor cash transfer recipients to training/skills development, and set aside employment for local unemployed poor (identified through social welfare agencies) in local public works programs. In areas where workfare programs exist, these programs could provide employment opportunities for the poor (providing cash for work) while incorporating work incentives for the poor.

4.31 *Finally, it will be important to ensure that conditional cash and in-kind transfer programs currently being piloted do not promote further fragmentation of the cash transfer system.* Effective cash transfer systems require considerable investment in government capacity to target and deliver benefits. In most countries, safety net reforms are consolidating diverse cash transfer systems (Latin America, Eastern Europe) to promote greater fiscal, targeting, and administrative efficiency in delivering benefits. Thus, it will be important that on-going pilots are eventually consolidated and administered (and targeted) through the main cash transfer system, rather than through newly created systems.

3. Complementing income support with community-based social care services

4.32 Social welfare services are an important complement to cash-based programs, but are still in their nascent stage in Pakistan. They should be scaled up only gradually, with careful evaluation of innovative models of care, with attention to fiscal costs, and underpinned by the development of a stronger institutional framework and stronger public private partnerships. Several options could be contemplated in this regard:

- *Focusing on a community-based approach for identifying and delivering services.* Social welfare services are often identified and delivered at the community level to ensure that services are tailored to the needs of communities. The provision of services to individuals in their local environments (vs. institutions) is also considered the best option for care. Capacity building and information campaigns at the community level will be required to strengthen awareness about vulnerable groups, reduce stigma, and increase knowledge about adequate care options.
- *Strengthening the public sector role in the framework for planning and policy, contracting, and quality assurance/oversight.* The public sector could focus on policy development, regulation, e.g., establishing the types of services to be provided, the groups eligible for services, the development of service standards, licensing arrangements for providers, setting targets for service delivery and monitoring and evaluation. The role of the federal and provincial government in the financing and administration of services also needs to be clarified.

- *Greater emphasis could be to focus on partnering with the private sector, including community-based organizations such as RSPs, to deliver services. Capacity building to handle the increasing diversity of providers will be required both at the central and local government levels, and also for private providers. The government will still need to provide oversight of services provided.*

4. Increasing Responsiveness to Aggregate Risks

4.33 **There is a significant amount of income volatility that remains uninsured in Pakistan.** Shocks, e.g., droughts and seasonal unemployment are the main causes of income volatility and, as a result, transitory poverty. Exposure to risk, e.g., (temporary) unemployment is common, with the average surveyed worker experiencing 40-60 days a year without employment.

4.34 **Pakistan has a major gap in programs that can be scaled up to address income/unemployment shocks that stem from unexpected natural disasters** (e.g., droughts, floods earthquakes) and the more expected seasonality in agricultural production. The wheat subsidy is costly, does not protect the poor from price shocks and could be phased out over time, underpinned by a well targeted cash transfer system (see Box 3.5). An effective cash transfer and social welfare and care system, suitably provisioned to expand in times of disasters, can provide the basis for responding to crisis and replacing ad hoc efforts to provide this type of assistance from scratch. However, these programs are by their nature targeted, so that their elasticity of response, particularly for more frequent shocks, is often low. Workfare, given its ability to expand and contract in times of disasters, could potentially complement these programs, but attention to design and implementation would be crucial to ensure its effective implementation. This section focuses on the potential parameters of a workfare program that could be piloted and evaluated for potential use in Pakistan.

Piloting Workfare

4.35 **Geographically and self-targeted workfare program could help address income loss as a result of droughts and seasonal unemployment** Workfare programs typically aim to increase access to income generating opportunities among the poor by providing short-term unskilled manual labor employment on infrastructure and other types of projects. These programs are usually self-targeted (see discussion below), which allows them to expand coverage during seasons of low labor demand or in the event of a shock, and to contract otherwise. Pakistan has experimented with similar types of programs in the past, and could also benefit from piloting and evaluating a workfare program that could be used to help workers cope with aggregate shocks.

4.36 **International experience suggests that a great deal of attention needs to be paid to program design and implementation in order to ensure maximum effectiveness and minimize leakages, and administration requirements can be substantial.** Key lessons for program design are provided below and in Box 4.4:

- *Selection of wage rate and targeting.* Program wage rates should be set low enough to encourage self-targeting (i.e., only the poor are willing to perform manual work at that wage) and avoid complex administrative structures. The recommended wage rate for a public workfare program is one slightly lower than the local wage rate for unskilled labor (about Rs. 100 per day for landless male labor in Pakistan, with about half for females,⁸²) even if this wage rate is below the minimum wage for the

⁸² The average agricultural wages in Punjab (Punjab Economic Survey) have increased over time and are about 160 Rs. per day (in 2000 prices). The Pakistan Safety Net survey gives a mean/median wage rate for landless labor as Rs. 90 per day (males); and about Rs. 55 per day (females). Wage variations across provinces would need to be reflected in program design.

formal sector. For example, while wages would have to be set to encourage self-targeting, Pakistan could consider a unified and gender-neutral wage rate of about Rs. 75 per day (US\$1.25).⁸³

- *Limits to program's participation and disincentives.* Providing 50 days of employment per worker may offer sufficient scope for consumption smoothing for most poor workers without undermining incentives to look for alternative sources of income. Data from the PSNS shows that workers in rural areas experience between 40-60 days of unemployment a year. Conditional on wage rates being low enough, demand for the program should then expand during periods when the opportunity cost of labor for poor households is low, normally the agricultural slack seasons, and contract when it is high. This would require the program to have enough resources on hand to expand its coverage whenever participation rates go up. Irrespective of seasonal variation, however, the program ought to be available throughout the year to serve an insurance function, giving workers the choice to join when needed.
- *Selection of projects to be supported by workfare program.* To ensure maximum impact on employment and income generation, the program should support projects with a high labor share. Community involvement in program participation would need to be encouraged (as in the case of RSP programs). In general, projects chosen should be labor intensive. Experience from a wide range of countries suggests labor shares could range from 50-75 percent of total costs. Program selection could also play an important role in helping communities build up risk mitigation mechanisms, particularly in what regards natural disasters in mountainous, drought-prone, and flood-prone areas. This could be done by selecting small projects that support reforestation, soil erosion reduction, water conservation, etc.
- *Timing and Seasonality.* As already noted, the program yields maximum benefits if it operates intensively during periods when the opportunity cost of labor for poor households is low, coinciding with agricultural slack seasons. However, the program should be in place throughout the year if it is to serve an insurance function, and should be ready to expand in times of natural disasters, as in the case of India's Maharashtra Guarantee Scheme.
- *Promotion of women's participation.* The program could be designed to enable women's participation. In Afghanistan, women were eager to participate provided conditions were conducive: activities for women and men were identified, and work gangs and locations were separated so women could work without being seen by men. Supervisors were female. India's Maharashtra Employment Guarantee scheme promoted women's participation through provision of employment within 5 kilometers of their residence and provision of childcare on site. Close to 40 percent of participants are women. In Zambia, women's participation increased when the mode of payment was changed from daily wage to piece rate to enable flexibility in timing. These considerations (timing, mode of payment, location, on-site childcare, etc.) suggest that public workfare activity can promote women's participation.

⁸³ However, if targeting via self-selection is found to be infeasible at this level of the wage rate, then other approaches need to be explored. One such approach that has proven useful in some countries is community targeting. Once a ceiling is set for participation, e.g., one third of households sending one worker to the program, communities could be asked to select one-third of the households. Some broad criteria for communities to select participating workers could be established, such as number of children, based on a proxy means test.

Box 4.4: How to design workfare?

International experience suggests that the most important design features of successful public works programs are:

- The wage rate ought to be set at a level no higher than the prevailing market wage for unskilled manual labor. This will enable poor individuals to self-select into the program thereby avoiding the cost of administrative selection of participants.
- It is best to avoid restrictions on eligibility; the fact that a person wants work at the offered wage rate would ideally be the only requirement for eligibility.
- If rationing is required (because demand for work exceeds the budget available at the wage set) then the program can be targeted to areas with high poverty. However, it is desirable to allow some flexibility in future budget allocations across areas, to reflect differences in demand for the scheme.
- The labor intensity (share of wage bill in total cost) ought to be as high as possible, while still maintaining the capital costs necessary for preserving the quality of the assets created.
- Workfare projects can be synchronized to the timing of agricultural slack seasons to ensure significant consumption smoothing of poor households.
- In order to encourage female participation piece rates or task-based wages may be considered, along with childcare arrangements.
- Transaction costs to the poor can be kept low by locating project sites close to villages.
- A good monitoring and evaluation system is required. By far the single most important drawback in many countries is the lack of base line and follow up information on participants. Without this information, the program, its targeting, and cost effectiveness cannot be assessed.

Source: Subbarao (2003) and World Bank (2001).

- *The cost of launching and fully implementing a workfare program under the above assumptions could be costly, about be Rs. 21-37 billion, or 0.4-0.7 percent of GDP, while a smaller, geographically targeted program could cost much less—0.1 percent of GDP (see assumptions below). Similarly, workfare could be targeted to particularly poor districts. In this case districts affected by the recent earthquake would be natural candidates. As noted above, the implementation of this program would require attention to administrative capacity and the availability of fiscal resources.*

5. Strengthening Safety Net Administration

4.37 Implementation issues in safety net programs noted in Chapter 3 can severely constrain benefit delivery, reducing the positive impact of any program. These include dispersed policy making capacity, a fragmented system, inadequate human resources, inadequate outreach, and the lack of information. The fragmentation of programs and lack of clear targeting and eligibility conditions also strain program administration. These problems are not uncommon to cash programs around the world and international experience suggests several steps that could be taken to improve administrative efficiency of programs.

Box 4.5: Phasing out the wheat subsidy

The wheat subsidy program does not meet its objectives of protecting the poorest against aggregate price shocks and introduces serious distortions in the wheat market (i.e., transport restrictions). There are a number of reforms that could be considered for reducing these distortions and reaching the poor. Resources allocated for the wheat subsidy could be used much more effectively for programs targeting the poor, such as cash transfers or food stamps. To date, reforms include increases in procurement prices, the promotion of private sector imports and government imports. Each of these initiatives has been attempted. To deepen reforms, two possible reform options could be considered:

- Increasing the release price of wheat sold to millers would help reduce the cost of the subsidy.
- A medium term solution, consistent with international practice, would be to reduce distortions in the wheat pricing, while still protecting the poor against adverse price shocks would be to allow gradual increases in wheat prices to reflect market levels, while supporting the poor through more targeted support to the poor, e.g., via food stamps or a strengthened targeted cash transfer program.

Transforming the wheat subsidy would be a major policy shift for Pakistan. Resources released from the wheat subsidy—which are considerable relative to the two main cash transfer programs—could be used much more effectively as additional resources for programs to target the poor.

Moving in this direction would require a thorough analysis and dialogue with government of who benefits from these policies, what are the real costs, and what policy and program alternatives exist to more effectively use scarce public resources to meet food security needs of poor households in Pakistan⁸⁴ (see also Box 3.5).

Better coordination of policy making and implementation

4.38 **Clearly defined roles of federal, provincial and local governments in delivering safety nets, and strengthening private partnerships.** The relative roles of central and local governments in ensuring program design, financing, quality standards, monitoring and evaluation will need to be clearly defined. These roles will need to be coordinated to ensure consistent safety net policy design, to ensure shared interpretation of the standards, adequate training and education of staff, including periodic assessments and potential for promotions (within the civil service system), codes of ethics, and the development and use of quality management tools. While there is no blue-print for delineation of institutional roles, and these roles may vary across countries, some general guiding principles might be used, as identified below.

4.39 **Central budget financing for safety nets?** Continuing federal financing for the main cash transfer programs allows pooling of resources that can be used to target the poorest regions and households. Thus, federal financing of Bait-ul-Mal should continue. While social welfare programs are often financed and provided by the provincial level, the government might consider co-financing these programs to ensure adequate provision for poorer provinces. There are two risks associated with provincial or local financing of cash transfers. First, there is a risk that the poorest local governments with the greatest need will be able to raise and spend few resources. Second, without earmarked financing sources there is a high risk that funds designated for social assistance programs will be diverted elsewhere. In several countries (Bulgaria, Romania, for example), decentralized financing mechanisms have resulted in substantial inter-regional disparities in coverage, with the poorer localities providing the least amount of services. This leads to a situation in which funds are not available to those who need them the most.

⁸⁴ For a brief summary of wheat policies in Pakistan see Dorosh (2004).

Program management: staff, outreach, M&E

4.40 Improving program monitoring through administrative, survey data and impact evaluations to provide feedback to policy. A variety of tools should be used to minimize leakages and poor governance in the system, though no system can eliminate them. To improve administration, it will be important to put in place a database management system that keeps information on applicants and beneficiaries; and tracks expenditures and payments. To promote quality at all levels, federal cost-sharing and financial incentives for municipalities need to be in place if they are to be charged with implementing data collection. The database could also include information on financing of the program, budgeted and actual expenditures and payment and payroll information. In addition to administrative data, safety net modules can be designed as add-ons to the main household survey (potentially over-sampling the poor) to also allow more information on their adequacy, coverage and targeting efficiency. Finally, impact evaluation of new approaches should be considered as a means of fostering innovation and assessing their applicability to country circumstances.

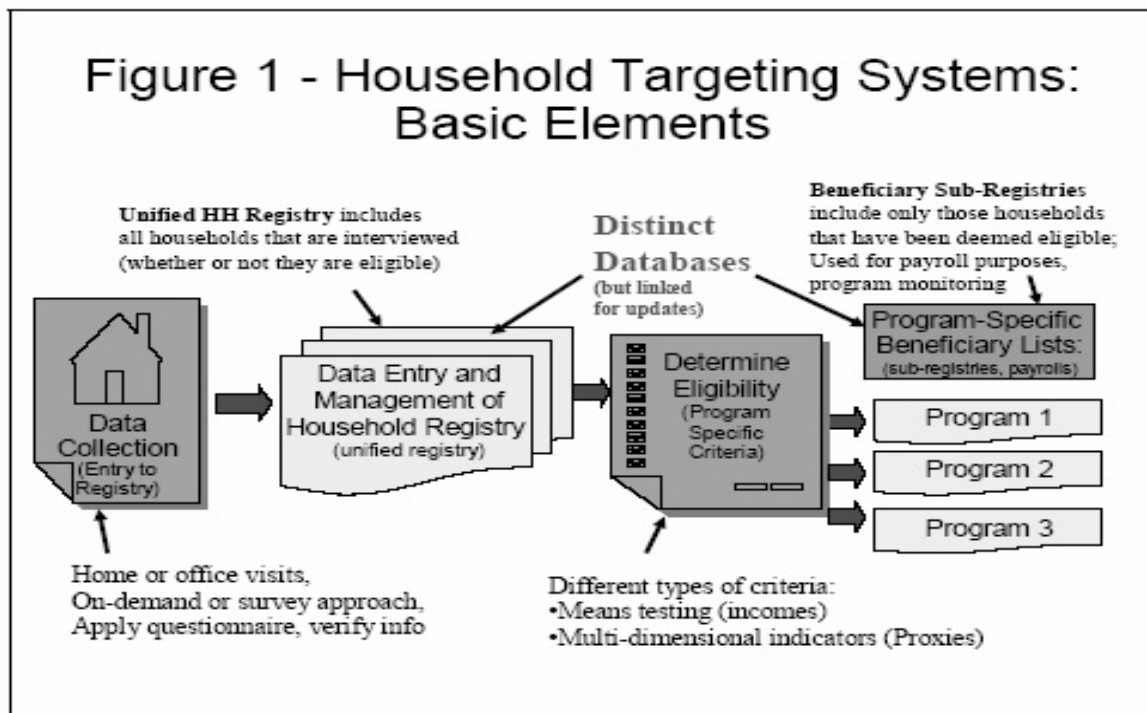
4.41 Strengthening program outreach. Safety net systems need sufficient outreach to local communities to implement the program. Program officials need opportunities and incentives to visit poor households and communities to identify and respond to their needs. Personal visits are needed to verify claims, monitoring beneficiaries, through random audits, automated checks, comparing registries with other data, and conduct random-sample quality control reviews. These procedures are important for improving the targeting of the program, as lack of information about the program is a barrier to applying for some poor households.

4.42 Widely publicizing the program and promoting feedback, particularly program conditions, e.g., eligibility requirements, modifications through information campaigns and outreach, are other ways to enhance transparency and improve program targeting. In addition, promoting feedback on program performance through beneficiary assessments and citizen oversight (“social controls”) can also strengthen program monitoring, e.g., posting lists of beneficiaries in public places in the communities, or conducting social audits.

Using information technology for improving administration. Improving service delivery will require investment in information technology appropriate for Pakistan’s level of income. Making prompt decisions and regular timely payments is critical for better service delivery in both cash transfer systems and can be facilitated by computerization of record keeping and payment information, which has been shown elsewhere to reduce processing times for benefit claims and helped to cut down on claim fraud. Pakistan’s use of a unique identification number would be very useful in developing this system. Similarly using efficient payment systems—partnering where possible with private providers, e.g., using banks, post offices, or other mechanisms to deliver payments directly to the beneficiaries and bypassing middle authorities helps to improve payment efficiency and reduce leakage (Box 4.6).⁸⁵

⁸⁵ New technologies including mobile computing, biometrics, satellite communications, simple and smart cards, global positioning systems, radio frequency identification tags, automated teller machines and solar power all hold great promise for improving.

Box 4.6: Targeting systems



Household targeting systems are commonly used to determine eligibility for cash transfer programs. With household assessment, an official (usually a government employee) directly assesses, household by household, whether the applicant is eligible for a specific program(s). While the actual design and implementation of household targeting systems varies significantly by country, most systems involve the following basic steps that seek to establish transparent, open and on-going processes for entry into the unified information registry, such that anyone may apply for program benefits at anytime (although qualification for program benefits depends on meeting program eligibility criteria—see Figure 1):

- Collecting data on characteristics of (potentially eligible) households via household-level interviews (either in offices, via home visits, or both);
- Entering these data into a unified information registry (with varying degrees of verification and consistency checks);
- Comparing data on household characteristics with pre-established eligibility criteria (program specific);and
- Establishing program-specific beneficiary lists (sub-registries) for the purposes of program implementation and payroll. Within this system, there is an important distinction between the **unified household information registry** (or “cadaster”), which includes all interviewed households (which may or may not be eligible for program benefits for an array of programs) and the **program-specific beneficiary lists (sub-registries)**, which include only households that have been screened and deemed eligible for specific programs.⁸⁶

⁸⁶ Castaneda and Lindert (2005).

4.43 **Qualified management and staff.** Last, but certainly not least, program administration is dependent on adequate network of offices with high quality staff and management. Staff will need to be trained in implementing safety net programs. For example, it will be important to train staff in targeting and eligibility conditions, as well as in the implementation of social care services. This will require attention to human resources, to strengthen the professional skills of staff, and potentially to increasing their presence at local levels. While Zakat has extensive outreach, Bait-ul-Mal and the Ministry of Social Welfare and Special Education have only district level offices to administer programs.

B. Improving social security: Reducing the risk of falling into poverty

4.44 A social security system allows individuals to avoid poverty by smoothing their consumption over their lifetime against idiosyncratic shocks (e.g., health, disability, loss of employment, and longevity). While Pakistan mandates social security to the formal sector—both public and private sector—extending social security to the broader population is a long-term challenge. It will require improved fiscal sustainability and administrative capacity of formal social security schemes, and greater formalization of the economy. In the interim, extending coverage to the informal sector might be considered through innovative approaches, e.g., piloting community-based health insurance.

Articulating a long-term vision

4.45 **Despite the longer term implementation, Pakistan could still consider a vision for a long-term social security system.** This longer term view would better enable the country to guide reform efforts in formal social security systems to underpin this system in the future. The first steps would be to strengthen mandatory public and private pension schemes, improving their fiscal sustainability, administration and record keeping—as already being considered by the government in the case of civil service pensions—and potentially consider piloting and evaluating innovative approaches to expand coverage to the uncovered sector.

4.46 **Establishing clear benefit targets for old age, disability and survivors' insurance, as well as defining health coverage are critical first steps toward formulating a coherent social protection strategy.** In order to finance these benefits, financing sources consistent with estimated costs based on actuarial calculations would be needed.

4.47 **Several factors make a more fundamental reform package attractive at the present time.** Rapid economic growth is raising incomes and making it possible for more households to save and insure. The international experience suggests that there will be more demand for consumption smoothing through public and private institutions. Population aging, albeit gradual at the national level, is more pronounced in the urban areas and salaried class. This could translate into greater demand for pensions.

4.48 **Related sectoral developments are also conducive to deeper reforms.** Important reforms in the financial sector have taken place, especially in the banking sector, providing a solid foundation for a new contractual savings sector. The first sign of this is the introduction in 2005 of the new Voluntary Pension Scheme (VPS) regulated by the Securities and Exchange Commission Pakistan (SECP). Along with parallel capital market reforms, the conditions for managing term-savings instruments are improving.

4.49 **Finally, a fundamental or 'systemic' reform may soon be under way for pension schemes covering public sector workers.** Recommendations for a systemic reform – one which would change the paradigm for future public sector pensions – have led to a more general reconsideration of issues such as funding, public management and parallel systems across pension provision in Pakistan. A Pension Reform Working Group was announced in March 2006, and a number of parametric reform measures for civil service pensions have been proposed recently in the context of a Pay and Pension Committee, but

have not been implemented. There is also a proposal to introduce a defined contribution scheme that would eventually lead to a fully funded pension scheme. These developments may open the door to fundamental rethinking of pensions and other elements of social security for the first time in several decades.

4.50 Fundamental reform requires identification of risks to be covered, definition of target replacement rates, and determination of financing parameters and administrative and implementation arrangements. The first step is to define the most important risks faced by households against which the system should offer protection—presumably disability, death, old age, loss of earnings for various reasons and health. The next step would be to define a target benefit level in each of the core areas (for example, a target replacement rate for pensioners). These targets would, in turn, imply certain costs based on actuarial projections. An explicit decision would then be needed as to what portion of these costs would be pre-funded or passed onto future taxpayers. Finally, the institutional and administrative arrangements that work most efficiently in terms of cost and risk pooling would be determined.

4.51 Transition from the current situation to the new long-term vision may take a generation to unfold. The preconditions for introducing a comprehensive social security system will require a considerable time to put in place in Pakistan. However, developing this vision will allow a more concerted and coordinated review of pension and social security schemes. Taking no action however, would simply maintain a system that is either inadequate or unsustainable, or both. In the meantime, effective change will require strengthening formal social security schemes (including improvements in the fiscal sustainability of private and public schemes, strengthening administration, and reducing duplication) and innovating on approaches to expand coverage to the informal sector. We focus here on the private and informal sectors, given that civil service reform issues have been extensively covered in a recent report (World Bank, 2006).

Strengthening formal social security systems

4.52 Expansion of coverage of formal social security systems requires improving their fiscal viability of schemes and strengthening program administration.

4.53 Increasing fiscal sustainability and financial management. To improve the fiscal sustainability of civil service schemes will require parametric changes in the system, e.g., changes in the assessment base, accrual rates and gradual increases in the retirement age will reduce short term and the present value of future spending fiscal costs. Systemic changes in the system—that is, a shift to a defined contribution system—will require up-front fiscal outlays, but will eventually lead to a more sustainable civil service pension system, reducing the present value of fiscal expenditures on pensions from 71 to 47 percent of GDP. Options for improving the fiscal sustainability of EOBI will also need to be considered. As the latest independent actuarial report finds that cash flows become negative in less than two decades, it will be important to consider options for improving the fiscal solvency of the program, with attention to improving its consumption-smoothing aspect. Improvements in the financial management of reserves will be required to ensure reasonable returns that can improve the financial sustainability of EOBI. Information on the management of other funds also needs to be improved, including strengthening independent oversight. Investment policy statements and process will need to be defined and disclosure improved.

4.54 Improving administrative capacity (recordkeeping and oversight). Monitoring systems will need to be strengthened to avoid evasion, thus strengthening the financial position of funded schemes. Improvements in tracking of individual earning histories in electronic form for the pension department to make accurate payments will be needed for parametric reforms in the civil service scheme. For systemic reforms such as the introduction of a Defined Contribution (DC) scheme, recordkeeping is much more

stringent. In this case, monthly tracking of individual employee accounts to adjust for changes in status and remuneration, and monthly reports to workers to facilitate any discrepancy in information and reconciliation of accounts. Improving enforcement mechanisms for late payments and reporting will need to be instituted. In all schemes, monitoring is weak and will need to be considerably strengthened.

4.55 Reducing program fragmentation. Administrative costs may be reduced through consolidation of certain activities (especially cash transfers) in one institution.⁸⁷ The idea of consolidating provincial schemes with the EOBI is not a new one and has been suggested by Pakistani and international experts. An initial step could be the harmonization of practices in a number of areas including reporting procedures, accounting standards, independent audits and actuarial evaluations. Also, given the overlap in membership and employer registers, some efforts to upgrade and centralize a common database might be considered. This may be possible through NADRA, for example. Simplifying the process for registration and collection for employers would also encourage participation by reducing their costs. In this regard, the current effort to consolidate legislation is a welcome first step, though processes for external oversight will be particularly important. According to officials, an effort is currently being made to consolidate legislation in this area. However, while an important first step, the ultimate problem may lie in the lack of oversight in the system and mechanisms for enforcing the legislation. Boards are tripartite and government controlled boards of monopoly social insurance institutions have shown that there is some need for external oversight. In a few countries, the financial sector regulator provides guidelines on basic governance issues such as reporting practices.

Extending coverage to the informal sector

4.56 There are two general approaches to extend pension and other social security coverage to informal sector workers. The first is to specify a table (ranging from simple to complex) of flat payments over time to be made by the worker and a flat payment to be made after fulfilling the eligibility requirements of age and vesting period. This approach seeks to retain a defined benefit but takes into account the fact that there is no regular wage to which a formula (such as the one EOBI) could be applied. The second approach is a defined contribution arrangement where accumulated contributions of varying amounts and periodicity are accumulated in an individual account toward an eventual withdrawal upon reaching old age. This approach allows greater flexibility and can be directly subsidized with a matching contribution from the government to increase take up. However, to date, there is only limited international experience with these two approaches (Table 4.4).

⁸⁷ ADB (2004), in close consultation with the Ministry of Labor, stated that “there should be some rationalization of the activities undertaken by social protection institutions to reduce duplication, concentrate on highest priority areas and to make accountability for outcomes clearer”.

Table 4.3: International experience with extending pension coverage to informal sector

Country	Scheme type	Other insurance	Status
Dominican Republic	Subsidized DC	life and disability	Law passed but not implemented
India (West Bengal)	Subsidized DC	none	Implemented; 650,000 members in 2005
India (Kerala)	Mixed DB and DC	various	Implemented
Indonesia	Mixed DB and DC	work injury, health, life	Law passed but not implemented
Mexico	Subsidized DC	unclear	Law passed but not implemented
Sri Lanka	Pseudo DB	life and disability	Implemented; 650,000 members in 2005
Thailand	Undecided	unclear	Law under consideration
Tunisia	Pseudo DB	life and disability, others	Implemented
Turkey	Pseudo DB	life and disability	Implemented
Vietnam	Subsidized DC	none	Draft law under consideration

Source: Palacios (forthcoming).

Note: “DB” means Defined Benefit; “DC” is Defined Contribution. Source: Palacios (forthcoming).

4.57 **One advantage of the defined contribution approach to old age pensions/social security is that the financing and administration of additional insurance products can be facilitated.** In particular, group contracts for disability and death insurance can be purchased from private firms based on individual account information available through the individual accounts pension scheme. Moreover, the actuarially fair premia can take into account the underlying balances and can therefore be lower than otherwise. Policymakers must however recognize that any subsidy required to achieve significant take up among informal sector workers will have to be provided up front. The advantage is that this may add fiscal discipline compared to schemes that incur unfunded liabilities that are not initially reflected in the fiscal accounts.

4.58 **Health insurance should be considered as a separate, and in many ways, more complex issue, and one which currently does not have enabling conditions for introduction in Pakistan.** Thus far, the discussion has centered on cash benefits such as old age, disability and survivor pensions and could be extended to unemployment, sickness, employment injury and other risks. Health insurance, above and beyond cash transfers to cover earnings loss in the face of health shocks, involve much more complicated implementation issues. Recommendations to extend the existing ESSI programs to self employed workers and to pilot HMOs have not been implemented in the last few years due to the complexity of the task involved and the constraints in terms of available medical facilities. In fact, the debate as to when and under what conditions it is appropriate to introduce mandatory social health insurance continues. Many of the conditions that favor this approach are not evident today in Pakistan.⁸⁸

4.59 **Microfinance institutions and other groups are also beginning to play a role in extending insurance to segments of the labor force that fall outside of formal mandates.** Neighboring countries like India and Bangladesh have seen a significant growth in micro insurance products on offer in the last few years, which could be repeated in Pakistan. However, the low penetration of MFIs (outside of Bangladesh) and particularly in Pakistan suggests that this strategy would have a long gestation period. However, there might be scope for using community-based groups for providing insurance products in Pakistan, and this possibility might be explored. As noted in Chapter 3, the new hospitalization insurance program offered by Adamjee Insurance through the rural support programs does just this.

4.60 **MFIs and other groups (like the rural support programs) could ‘plug into’ a formal sector arrangement such as the defined contribution pension cum insurance model described above.**

⁸⁸ For example, see the cautions regarding premature introduction of compulsory health insurance and the relevant experience in Asia in Gertler (1998).

Combined with reforms to the formal sector schemes (described above), this could create a seamless system of pension coverage and eventually, other group insurance. It would allow easier movement between informal and formal, public and private sector work and reduce administrative costs that would tend to be duplicated under parallel schemes. In this regard, the implementation of the recent hospitalization insurance program of the rural support program will have to be carefully followed and evaluated.

4.61 **Social pensions?** As noted in Chapter 3, social pensions are another means of providing protection in old age to informal sector workers. The results of the NWFP pilot social pension scheme will need to be carefully evaluated prior to expansion. As also noted above, these schemes can have extensive fiscal costs (depending on their design) and opportunity costs (in terms of directing cash transfers from other poor groups).

IV. CONCLUSIONS

4.62 In this chapter we have laid out possible reform options for social protection that address the challenges identified in Chapters 2 and 3. This agenda combines recommendations to improve the effectiveness and efficiency of existing programs with suggestions about the creation of new programs in those areas where the current program mix fails to provide adequate support. The discussion has touched upon both general and specific aspects of the proposed reform with the objective of stimulating further debate at various levels—from broad reform principles, to costing, to institutional and implementation arrangements, to changes in specific programs. It has emphasized that piloting and evaluating programs and attention to adequate administrative capacity and fiscal resources are essential for developing viable social protection systems. As we mentioned in Chapter 1, we hope that the material presented in the chapter and, more generally, in this report serves as an input for the government in preparation of strategies and policies. In this sense the report, and particularly this last chapter, is meant to be seen as food for thought rather than as a blueprint. Ultimately it is clear that decisions about the direction and magnitude of reforms efforts rest with the government and its stakeholders.

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