Policy Responses to Economic Inequality in Pakistan:

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Economic inequality is of two types – inequality of economic outcomes, and inequality of economic opportunity. Distributional inequality, measures using statistics like the Gini coefficient, deals with the inequality of economic outcomes. The inequality of economic opportunity is examined with respect to structural inequalities based on gender, region, economic class and social identity.

Distributional inequality is not a policy concern in its own right in Pakistan. Concern about inequality is derivative of the goal of poverty reduction. Inequality reduction is raised as an issue only after a particular round of economic growth has failed to deliver rapid poverty reduction.

There is a consensus in the framework of economic policy-making around fiscal prudence, conservative monetary policy, inflation-targeting, privatization, external openness and market-orientation. In fact, alternative positions are available in macroeconomic management and economic reforms, and ex ante poverty and inequality impact analysis of alternative scenarios must be an integral to policy making.

The policy instruments available for affecting distributional inequality are weak, and have not strengthened over time. Taxes have remained stagnant as a proportion of national income, and direct taxes account for only around 4 per cent of the GDP. The PRSP process has led the government to identifying a number of expenditures as poverty-reducing without a rigourous analysis of their poverty impact. Social protection allocations have increased significantly in the current fiscal year, but targeting and implementation mechanisms are ineffective.

Poverty reduction is a consequence of sufficient growth in the consumption or income of those below the poverty line and no corresponding declines in incomes above the poverty line. It is difficult to predict the effect of policies and economic changes on poverty without making assumptions about distribution. Policy choices must be informed by their impact on growth and distribution, even if the outcome of interest is poverty reduction.

Pro-active policy measures are needed to counter structural inequalities that lead inequality of opportunity. Structural inequalities are correlated with geographical and historical patterns of deprivation, market segmentation, and unequal access to public services. There are four key dimensions of structural inequality in Pakistan: (a) gender, (b) region, (c) economic class, and (d) social identity. These forms of inequality represent vicious circles of poverty and inequality.

Markets do not provide simple solutions to structural inequalities. Rather, in the absence of pro-active policy initiatives, markets are likely to reproduce existing geographical, historical and social inequalities.

There is little policy focus on economic aspects of gender inequality. Issues such as women's ownership of property, gender discrimination in labour markets, constraints to greater female labour force participation, and the linkage between economic opportunities and women's empowerment are important in economic policy-making.

Inequality and hierarchy based on social identity – race, caste, ethnicity, kinship group, religion and sect – is a pervasive feature of the economy that remains virtually invisible in the policy discourse.

Recommendations

1. There must be an explicit focus on distributional inequality in economic policy-making.

2. Macroeconomic management and economic reform policy choices must be subjected, ex ante, to rigourous poverty and inequality impact analyses.

3. Government must take the lead in establishing objective and officially-owned regional and sub-regional rankings,and poverty and development scores, which might be used for regional resource allocations.

4. The Ministry of Finance and the Planning and Development Department must take forward the work done on gender budgeting and institutionalize gender-disaggregated policy impact analysis across the range of policies.

5. Research must be commissioned on social identity as a determinant of structural inequality. Specific attention should be paid in these studies to issues relating to race, caste, kinship group, ethnicity, religious and sect, in the processes of social marginalization. Research findings must be presented and debated at policy and opinion-making forums including various levels of government, parliament, media, and civil society platforms.

6. The Finance Ministry must move towards the expansion of the tax base, increasing reliance on direct taxes, and introduce progressive scales in taxation.

7. The PRSP should carry out rigourous analysis of the poverty impact of different elements of government spending.

8. The Planning and Development Department should work with ministries and sub-national governments to institutionalize a comprehensive system for targeting and implementation at the local level. Targeting and implementation systems must have three key components: (a) compact territorial units, (b) concept of a universe (c) pro-active measures to ensure coverage and outreach.

9. Schemes for asset transfers such as the allotment of agricultural land, and more importantly, homestead plots for rural labourers need to be reviewed and revived. Existing schemes for the use of state land for the regularization of irregular settlements in urban areas should be reviewed and expanded.

10. Affirmative action in favour of groups facing inequality of opportunity (women, individuals from deprived regions and socially marginalized groups) must be instituted or significantly enhanced in government employment, educational opportunitiesand asset transfers.

11. Non-fiscal measures include legal changes that allow collective action on the part of workers in the informal sector, effective tenancy and labour adjudication, and pro-active measures to combat bonded labour.

1. Introduction and Conceptual Overview

This paper aims to examine policy responses to inequality in Pakistan on the part of the government as well as international development partners and non-governmental actors. The paper is divided into four sections. Section 1 discusses the various approaches to economic inequality, and proposes a conceptual framework for analyzing policy responses. Section 2 reviews policy responses to distributional inequality, while Section 3 examines responses to structural inequality. Conclusions are offered in Section 4.

1.1 Economic, Social and Political Inequality

Economists and policy-makers think about economic inequality in a variety of different ways. The most important distinction is between unequal outcomes (such as income, consumption or wealth) and inequality of opportunity (such as natural endowments, discrimination, segmented markets or structural inequalities in access to public resources).

There are many possible dimensions of inequality that are of interest to policy-makers. Besides economic inequality – or inequality in economic outcomes or opportunities – there are social and political dimensions of inequality. A person might be regarded as occupying "low" status and this might primarily be a social issue. If a segment of the population enjoys lesser rights – on any ground – this would be a sign of political inequality. This paper, however, is interested primarily in economic inequality. Social and political dimensions of inequality enter the discussion here only insofar as they have implications for economic outcomes and opportunities.

1.2 Inequality of Economic Outcomes

Consumption, income, and even wealth can be regarded as economic outcomes that depend on prior resource endowments, realizing the value of human and other resources, windfall gains, adverse shocks and other intervening economic factors. Even though wealth is a stock and not a flow, it can still be regarded as a current economic outcome of past social and economic events. Since consumption and income are flow variables, they are more proximate indicators of welfare. Inequality in economic outcomes may not necessarily be a policy concern in its own right. Incomes, for example, can be unequal because of differences in endowments, skills, entrepreneurship, or sheer luck. They might also be unequal because of persistent distortions in markets and economic opportunities.

Although economic policy is ultimately concerned with individual welfare, virtually all empirical analysis of inequality in economic outcomes in Pakistan treats households as the primary unit of analysis. This is partly due to the fact that the household is seen as an integrated unit of production and consumption. Unlike the situation in industrial economies, in Pakistan, the household does indeed function as an integrated unit in many sectors such as agriculture. While the focus on the household instead of the individual is justified on the grounds of data constraints, it obscures the possibility of severe intra-household inequalities in the apportionment of consumption, particularly on the grounds of gender, age, marital status, or relationship with the household head.

1.3 *Inequality of Economic Opportunity*

While the equality of economic outcomes such as consumption, income and wealth is not a straightforward policy objective, there are stronger policy arguments in favour of equality of economic opportunity. Many aspects of equality of opportunity – such as equal wages for equal work – are embedded in constitutional guarantees and the law. But whether or not equality is protected by law, the inequality of opportunity is universally regarded as unfair. Moreover, inequality of opportunity is often associated with market distortions, and might attract policy attention on grounds of economic efficiency.

Three types of inequalities of economic opportunity are salient:

- Regional underdevelopment: Some regions have poor endowments of physical and institutional resources due to terrain or the historical patterns of development. Remote areas of Pakistan, with fragile agro-climatic conditions, and regions with under-developed physical and institutional infrastructure fall under this category.
- Market distortions: There are distortions in the way markets function which affect economic opportunities of segments of the population. Women, for example, face restricted market access due to prevailing social norms. Socially marginalized communities such as those trapped in a caste hierarchy as well as religious and ethnic minorities also come under this category. Some groups face favourable market conditions due to the importance of personal connections in market transactions in Pakistan.
- Unequal access to public services: There might be inequalities in access to public services due to social marginalization, poor governance or political interference. Some of the factors that lead to unequal access to public services are identical to those that lead to market distortions.

The inequality of economic opportunity may not always show up as inequality in economic outcomes. Population distribution measures such as the Gini coefficient, therefore, may not pick up on structural inequalities or inequalities of opportunity. It is possible, for example, for a household facing disadvantage in terms of economic opportunity to compensate for this by deploying more labour and enjoying less leisure. In distributional analysis this household will appear to be doing as well as other households that do not face discrimination, but only because its members accepted more work and less leisure to compensate for their social disadvantage. Unequal opportunities also imply that people with higher levels of human capital from a disadvantaged group might end up earning no more than those with smaller human capital from an advantaged group. An apparently egalitarian income distribution may not be grounds for complacency, as it might conceal deep-seated structural inequalities.

1.4 Policies that Influence Economic Inequality

It is obvious that a wide range of policies are bound to influence both types of economic inequality. Prominent among these are macroeconomic policies, fiscal policies, sectoral policies, policies that guide public or private investments into various regions, investments in physical and institutional infrastructure, and legal changes and enforcement of laws.

Since virtually every policy decision has implications for economic inequality it is necessary, for the purposes of the present review, to limit the focus of policy analysis to more manageable proportions. There are some areas of policy-making that are of more direct relevance to outcome inequality. These might include tax and subsidy policies. Other areas have a direct bearing on equality of economic opportunity – such as regional development policy, gender, and social sector development.

1.5 Policy Responses to Economic Inequality

Another way to gain some focus is to identify those policy responses that are specifically addressed to economic inequality. In other words, to what extent is economic inequality seen as a problem to be addressed by policy-makers, and what are the main tools they have used in order to address this problem? The main sources of information in this case will be policy statements that set out economic priorities, which will be used to ascertain if inequality has been a policy concern, and what policy responses if any have been forthcoming.

1.6 Distributional and Structural Inequality

The above classification of economic inequality into "inequality of economic outcomes" and "inequality of economic opportunity" maps broadly into two types of policy concerns: distributional inequality and structural inequality.

Outcome inequality is interpreted in operational terms in the policy discourse through distributional measurement. The distribution of consumption or incomes in a population can be measured using statistics such as the Gini coefficient, or ratios of consumption or income attributed, respectively, to the top and bottom segments of a population.

Inequality of economic opportunity corresponds with various dimensions of structural inequality. Groups facing unequal opportunities are identified ex ante on the basis of sociological and political knowledge, and not necessarily identified from ex post distributional analysis. Structural inequalities with respect to gender, class, caste, ethnicity, region, remoteness, and religion are thought to be important in Pakistan regardless of whether and to what extent they can be measured adequately using distributional analysis of outcomes.

2. Responses to Distributional Inequality

2.1 Inequality, Poverty and Social Protection

Policy discussion of distributional inequality in Pakistan is often compounded with the discussion of poverty reduction and social protection.[1] In comparison with poverty reduction and social protection, however, the reduction in distributional inequality has not been a prominent concern in its own right for government and international aid partners.

Table 1 lays out four types of scenarios with respect to growth and poverty reduction. These scenarios acknowledge that the relationship between growth and poverty reduction is non-linear. High growth can and does lead to speedy poverty reduction, and low growth is generally associated with increases in poverty or slow poverty reduction. But it is also possible for low growth to result in speedy poverty reduction, and high growth to coincide with stagnant poverty reduction.

Table-1
Growth and Poverty Reduction Scenarios

	Negative / Low Growth	High Growth
Poverty increase/ Low Poverty Reduction	**Economic crisis, stabilization - Part of 1990s, current period** **Social protection**	**1960s** **2000s** **Inequality**
Speedy Poverty Reduction	**1970s** **Sustainability of poverty reduction**	**1980s** **Marginalization**

Inequality becomes an important political and policy concern only in those periods when high growth does not result in speedy poverty reduction. In periods of low growth and speedy poverty reduction the main policy concern is with the sustainability of poverty reduction. In periods of low growth and poverty stagnation or increase, the critical policy issue is to protect the vulnerable from extreme deprivation. At times of high growth and speedy poverty reduction it is correct to focus on pockets of marginalization that get left behind in the overall process of poverty reduction.

1This is brought out in detail further below with reference to policy documents. Government documents are not alone, however, in compounding the issue of distributional inequality with that of poverty reduction. The SPDC Annual Report on "Growth, Inequality and Poverty" (SPDC 2001), for example, focuses almost entirely on poverty reduction and social protection interventions while discussing policy responses to inequality.

High growth and speedy poverty reduction

Taking a long view of Pakistan's experience with growth, poverty reduction and inequality, the 1980s were a period of high growth and speedy poverty reduction. There were significant segments of the population – for example regions such as southern Punjab – that were left behind during this period of rapid growth. While growth proved to have been built upon unsustainable foundations in that period, poverty reduction was fairly substantial.

Low growth and stagnant poverty reduction

Low growth and poverty increase or low poverty reduction is the landmark of periods of economic crisis and stabilization. It might be argued that over much the 1990s up to around 2002 Pakistan's economy was characterized by relatively low growth rates and stagnant or increasing poverty. The current period too, starting from around 2007 can be categorized as a time of slowing growth rates and rising or stagnant poverty. Social protection measures ought to receive priority in such periods because stagnant or rising poverty ratios are inevitable in the case of both prolonged economic crisis as well as through stabilization. The 1970s and periods of its type are arguably rare when low growth coincides with speedy poverty reduction due to dramatic distributional change.

High growth and poverty increase/low poverty reduction

There are two significant periods in Pakistan when high growth did not lead to rapid reductions in poverty. The first was in the 1960s when despite rapid industrial and agricultural growth, poverty remained stagnant. This was partly due to structural inequalities across regions, and partly due to the highly class-segmented nature of growth. Real wages of workers and earnings of the rural landless and land-poor remained stagnant through a period of rapid industrial expansion. Perceptions of inequality became potent factors in political mobilization against the model of growth, ultimately leading to its demise. The second significant period when high growth rates did not translate into rapid or sustained poverty reduction gains was the most recent period from around 2002 till 2007 when once again, perceptions of rising inequalities led to political alienation from the economic model being pursued.

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2.2 Broad Macroeconomic Policy Climate

Macroeconomic policy options have remained somewhat limited in Pakistan since the early 1990s when a consensus emerged between the major stakeholders around fiscal prudence, inflation-centred monetary policy, and market-oriented exchange rates. The consensus was achieved by default in the absence of any substantial defence of earlier macroeconomic models that allowed greater scope for trade-offs between growth, employment, inflation and exchange rate stability. In actual fact, however, the consensus did not translate into consistent implementation. Fiscal targets were routinely ignored, the supposed insulation of monetary policy frequently violated, though with some exceptions financial openness to the external environment was maintained.

The macroeconomic consensus has been mostly silent on the issue of distributional inequality. With respect to poverty, it is assumed that macroeconomic stability will lead to economic growth, which in turn will create favourable conditions for poverty reduction. The macroeconomic consensus has been part of a wider policy framework that favours reduction in untargeted subsidies, privatization, and market-oriented reforms.

Macroeconomic policy priorities can be gauged from a reading of official statements and documents. There are three main sources of macroeconomic policy-making: the Ministry of Finance, the Ministry of Planning and Development, and the State Bank of Pakistan. The Ministry of Finance is considered to be the most powerful of the three, followed by the State Bank of Pakistan, and then the Ministry of Planning and Development. The key policy priorities of these arms of government are set out in their respective policy documents and reports which are reviewed below for their references to inequality.

Budget Speeches and Economic Survey

Federal government budgets are useful documents for gauging policy priorities of the Ministry of Finance. While historical allocations dominate budget-making, the budget speech, which follows the publication of the Economic Survey, is also seen as the government's annual assessment of the state of the economy.[2] Of the Economic Surveys reviewed, only the very recent ones (2005-2006) included discussion of inequality. This discussion was based entirely on reporting the findings of household budget data-sets in distributional inequality. The link between economic management and outcome inequality was not explored or analyzed. A review of the annual budget speeches going back to around ten years was carried out in order to identify any specific statements, analyses, diagnoses and recommendations with respect to economic inequality. The initial review of these documents revealed that "economic inequality" was not mentioned as an explicit concern in any of the budget speeches. It was decided, therefore, to expand the scope of the review to include references to poverty and poverty reduction. The results of the review are summarized here along with page references. Actual fiscal trends are analyzed further.

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1997-1998 (page 25)

- Initiative was taken to assist the rural population to organize itself into effective and well managed village organizations that can resolve their own problems through co-operation Food security programme for the very poor families
- Zakat and Ushr ordinance was amended in order to effect administrative changes 1998-99 with no reference to poverty or inequality

1999-2000 (page 47)

- Announcement of Pakistan Poverty Alleviation Fund (micro-finance)

2001-01 (page 25)

- Announcement of an integrated small public works program for poverty reduction. The program was to create employment and income augmenting opportunities for the urban and rural population
- Announcement of Food Support Program
- The system of Zakat and Ushr was revamped and revitalized
- Launch micro credit program

2001-02 (page 14)

- Announcement of Khushal Pakistan Program
- Food Support Program
- Khushali Bank

2002-03 (page 95)

- Reference to PRSP-I

2003-04

- Initiated the Tamer-e-Watan Program
- Increased the subsidy for Food Support program from Rs.2,000 to Rs.2,400
- Reported performance of Khushali Bank

2004-05 (page 20)

- Increased the food subsidy from Rs.1,200 to Rs.2,400
- Coverage of Khushali Bank was enhanced from 38 districts to 60 districts
- Increased the funds for the PPAF from $100 Billion to $250 Billion
- Established the National Technical and Vocational Training Authority
- Launched pilot program for rural development
- Developed cottage industries through SMEDA and micro-finance institutions

2005-06 (page 16)

- Enhanced the funds available for Khushal Pakistan Programme

2006-07 (soft copy, page 20)

- Rozgar scheme started in July with Rs. 12 billion

2007-08 (page 21)

- Presented the performance of Rozgar Scheme
- Increase the beneficiaries of Micro-Credit Bank from one million to two million.

2008-09 (page 24)

- Launched the clean water initiative to improve the quality of life for the poor
- Launched the Benazir Income Support Program (Rs 34 billion)
- Revived the People's Works Program (Rs 28 billion)
- Set up human resources development commission
- Established People's Rozgar Program

This review of budget speeches going back to 1997-98 suggests a number of patterns. First, there is no explicit mention of inequality as a policy concern. All of the statements highlighted here refer to poverty and poverty reduction policies. It is clear that over the last decade inequality has not been seen as a problem of economic policy by at least the Ministry of Finance.

Second, poverty reduction measures are seen primarily from the perspective of expenditures, and not at all from the perspective of revenues, relative prices, addressing market distortions, or regional and sectoral investments – all of which are issues that fall within the scope of federal budget-making. It will be seen below that there is a close correspondence between the approach in the budget speeches and that adopted in the Ministry of Finance's Poverty Reduction Strategy Paper (PRSP).

Third, poverty-focused measures are seen as falling broadly into three categories: social protection, public works and micro-finance. With respect to social protection, the main interventions include food support programmes, Zakat and Ushr, and cash transfers. The most recent budget speech (2008-2009) vests special attention into cash transfers through the Benazir Income Support Programme – this is discussed in detail below with reference to targeting mechanisms. Public works are mostly seen as providing rural infrastructure to poor communities, and their potential role in employment generation for the poor unemployed has remained largely unnoticed and under-utilized. The major stress on micro-finance as a poverty reduction intervention in the budget speeches has remained strong since at least as far back as 2000-2001. Actual experience of micro-finance in Pakistan and elsewhere has not been seriously scrutinized, despite persistent claims being made about its success over nearly a decade[3]

3 There are unsubstantiated statements in budget speeches and elsewhere (e.g. PRSP reports, vide Annual Report 2006-2007), that claim without citing any evidence that rural female unemployment has declined due to micro-finance schemes.

Poverty Reduction Strategy Paper (PRSP)

The Poverty Reduction Strategy Paper (PRSP) was initiated in 2001 as the focal point of poverty reduction policy in agreement with international donors, notably the International Monetary Fund (IMF) and the World Bank (WB). A PRSP secretariat operating within the Ministry of Finance prepares updates on the progress of the implementation of the poverty reduction strategy. In reality, PRSP updates consist of two main components: reporting of poverty and inequality trends, and reporting of designated PRSP expenditures. The former is based on the analysis of household budget data produced by the Federal Bureau of Statistics. The methodology for the latter involves identifying public expenditures that can be classified as "poverty-reducing", and then reporting trends in these expenditures in the federal and provincial budgets. The PRSP classifies a range of public spending on social sectors and public investments as poverty-reducing expenditures.

The linkage of these expenditures with poverty-reduction – let alone inequality reduction – is classificatory rather than rigourous. PRSP expenditures are reviewed below in the section on fiscal trends. A summary of the analysis of poverty and inequality in the PRSP framework and policy recommendations is provided here on the basis of a review of selected recent PRSP policy documents and progress reports.

These include two Annual Progress Reports (2004-2005 and 2006-2007), and several Quarterly Progress Reports (from 2004-2005 and 2005-2006). The coverage of PRSP documents is selective and not comprehensive, but it does provide a fair representation of the analytical framework of the PRSP and recommendations contained therein.

The PRSP was seen as an "evolving document". PRSP-I, or the first PRSP which followed an Interim PRSP agreed with the WB/IMF in 2000, was based on delivering poverty reduction through growth. The Annual Progress Report 2004-2005 provides a useful summary statement of the strategy:

"The PRSP is based on broad principles of engendering growth, investment in human resource development, bringing improvement in the governance, targeting the poor through public policy interventions and providing safety nets to the vulnerable; with an overarching goal to ameliorate human development and social protection. The two pronged strategy comprising well-targeted anti-poverty outlays and social safety transfers are essential elements of its comprehensive poverty reduction strategy."

It is clear that inequality reduction is neither an explicit objective nor an instrument for poverty-reduction. In effect, the PRSP process was reduced to regular reporting of public expenditures ear-marked as poverty-reducing. The second prong of the two-pronged strategy mentioned in this summary statement, that is social safety transfers, was also left aside as residual business for the next phase, or PRSP-II.

While poverty is obviously a persistent theme in the PRSP documents, inequality is mentioned only sparingly and that too only in the most recent reports. In the eight documents reviewed – Annual Progress Reports for 2004-2005 and 2006-2007, and Quarterly Progress Reports for 2004-2005 and 2005-2006 – outcome inequality is mentioned as an explicit issue in just four of the reports, mostly the recent ones.[4]

4 Inequality of economic opportunity is mentioned in several PRSP reports with reference to gender and urban-rural disparities in education and other social sectors.

There are two ways in which outcome inequality is mentioned. The first is through a presentation of the trends in inequality in some reports, measured through changes in statistics relating to distribution of income or consumption in the population. The other mention is with respect to the broad direction of policy. Quarterly Progress Report Q3 2005-2006, for example, mentions that while PRSP-I was mostly about growth, it was the aim of PRSP-II to ensure the inclusion of the poor in the growth process. This report also focuses on tackling inequality in order to reduce poverty and to bring marginalized groups and backward regions into the mainstream.

A very different approach is advocated in Quarterly Progress Report Q1 2004-2005 which mentions the need for equitable income distribution, and the role of economic growth, price stabilization, employment opportunities and social sector development in achieving this goal. While the 2005-2006 approach is cognizant of structural factors in poverty reduction, the earlier 2004-2005 approach is based on the idea that existing economic priorities will lead to an equitable distribution of income.

The divergent analyses of inequality and its linkages with poverty reduction is probably some reflection of an evolving understanding of issues, and the growing salience of inequality through the 2001 to 2007 period. PRSP reports provided useful statements of intent but as shown in the review of budget speeches these statements found little reflection in actual policy decisions.

The Draft PRSP-II was prepared at a time when despite a controversy over poverty numbers, there was a widespread perception that the policies followed in the period following 2001 had not delivered effective poverty reduction despite strong macroeconomic growth. Results of various data sets that became available at the time also indicated that inequality had worsened during this period.

PRSP-II is based on seven pillars. Pillar 1 identifies the demand side as a key driver of economic growth and particularly commends a strong middle class with growing purchasing power. While the PRSP-II does not specify the size and location of this class on the income scale, it is likely to belong to the upper income categories. This is in fact not very different from the growth strategy followed during PRSP-I where consumer demand from the upper income groups was thought to stimulate other sectors.

Equality concerns are addressed somewhat under Pillar 3 (human development), and Pillar 7 (targeting the poor and vulnerable). The former recommends some non-budgetary ways of reducing inequality of opportunity (mostly with respect to women's empowerment), and a number of other measures including micro-finance and employment programmes. The most substantial proposal under Pillar 7 is the institutionalization of a National Social Protection Strategy. This calls for expanding the coverage of cash transfers to the poor, and initiating measures for considerably improving targeting and implementation. These measures were taken up to a considerable degree in 2008-2009 in response to economic crisis and stabilization (discussed below).

State Bank of Pakistan Reports

According to the macroeconomic policy consensus that has been in place since the early 1990s, the central bank (State Bank of Pakistan) is supposed to be an equal partner of the Ministry of Finance in managing the economy. Central bank autonomy – and its primary mandate of calibrating financial variables such as money supply and interest rates in pursuit of macroeconomic stability – is a cornerstone of the consensus. In actual fact, central bank autonomy has been routinely violated when governments steamrollered monetary expansion.

Nevertheless the central bank is a powerful player in the economy – more so than the Ministry of Planning and Development, which lost its pre-eminence in the 1980s – and its analysis of economic conditions is read with care and consideration. The bank also emerged as an influential player in the post-2001 period when the financial sector was deemed as the lead sector for economic growth. Many of the regulatory decisions that allowed the unprecedented rise of the financial sector were taken by the central bank.

A review of seven Annual Reports (from 2001-2002 to 2007-2008) of the State Bank of Pakistan – the flagship document that is seen as a statement on the economy that is somewhat autonomous of the finance ministry – reveals that only the most recent three (starting 2005-2006) concerned themselves with poverty and inequality. These reports presented household survey data analysis to show that inequality had increased despite growth and poverty reduction. The 2007-2008 report also commented on poverty reduction initiatives of the government, focusing mainly on social protection, education, regional development, micro-finance, and sectoral support to agriculture.

While these statements and analyses might be of some interest as additional sources of information, they are mostly in line with what is already known and acknowledged by the finance ministry. There is no attempt here to prospectively, let alone retrospectively, gauge the impact of the State Bank's own policy choices on poverty and income distribution. Given the emergence of the central bank as a supposedly autonomous source of economic policy-making, this is an important omission.

Medium Term Development Framework (MTDF)

The MTDF replaces the five-year planning process of the Planning Commission (Planning and Development Division). The MTDF (2005-2010) and its mid-term review (MTR) in 2008 were examined. The MTDF closely follows the pattern of the PRSP and provides further detailed information into various sectors and linkages. Inequality is raised as an explicit concern only with respect to the political sustainability of growth and poverty reduction. The main instrument suggested by way of course correction is the increase in some high-end taxes such as capital and wealth taxes, and the redistribution of these revenues to the poor. No analysis is offered about the precise policy options with respect to tax changes, and the way in which the revenue thus raised is to be spent on the poor. The PRSP formulation of designated "poverty-reduction" expenditures is followed, and in line with the PRSP approach, no analysis of the impact of these expenditures is offered.

Although poverty (and inequality) reduction are mentioned as goals of the MTDF, little evidence is provided about whether the Public Sector Development Programme (PSDP) – a remit of the Planning Commission – actually does address this priority. The MTDF repeats the view that public works programmes such as the Khushal Pakistan Program (KPP) generate employment without acknowledging or addressing the lacunae in assessing the employment generation impact of these programmes.

Stabilization Programme 2008-2009

The economic crisis that emerged in 2007 in the shape of rising inflation, pressure on the exchange and a collapse in asset prices had its roots, arguably, in the macroeconomic and sectoral policies of the previous years. Stagnant tax-GDP ratios, failure to pass-through international commodity price rises, and reliance on non-export generating capital inflows to shore up external balances proved to be unsustainable. The macroeconomic crisis manifested itself in the shape of rapid inflation, a slow down in growth, severe stress on public finances, and the running down of the country's foreign exchange reserves. A range of stabilization measures has been proposed, and some of these have been approved by the government as well as international financial stakeholders (notably IMF).[5]

The stabilization measures include scaling down public spending, raising tax revenues, reducing untargeted subsidies, as well as increasing allocations for social protection measures. The stress on expanding and improving social protection measures is a unique feature of the current stabilization programme. This is partly due to the prior political commitment of the newly formed federal and provincial governments – as illustrated by an unprecedented rise in allocations for social protection in federal and provincial budgets.[6] It will be fair to argue, however, that Pakistan was moving in the direction of greater social protection commitment even before the macroeconomic crisis threw up the problem into sharp relief.[7] Internationally too, social protection became integral to the design of stabilization and recovery programmes. A good measure of the political impetus behind policy interest in social protection – both nationally and internationally – is due to the widespread concern that economic growth in the recent period was not as inclusive as it might have been, and that inequality increased throughout the period of rapid macroeconomic growth.

5 Planning Commission (2008), "Stabilization with a Human Face", report of the Panel of Economists to the Prime Minister.

6 The total new allocations of the federal and the Punjab provincial government to targeted cash transfers amounted to Rs 56 billion (Rs 34 billion for BISP and Rs 22 billion for the Punjab Food Stamp Programme). Actual spending, however, is likely to be smaller because these schemes were not fully operational throughout the fiscal year. This nevertheless represents nearly a six-fold increase in targeted cash transfers over the previous fiscal year.

7 The National Social Protection Strategy of 2006 represents an important effort in this regard – even though matching fiscal commitment was not forthcoming when it was first agreed.

2.3 Fiscal policies

Recent Fiscal Trends

The tax-GDP ratio has remained stagnant in the last few years around the 10 per cent mark (Table 2). Within tax revenues the share of direct taxation has risen from 35 per cent to around 40 per cent between 2001-2002 and 2007-2008. This means that direct taxes represent around 4 per cent of GDP. There are two main sources of direct taxation – individuals and companies. Rates of corporate taxation have declined in the last decade in line with other "investment-friendly" policies.

Personal income tax structure is supposed to be progressive – with higher rates for higher income groups. Several regressive aspects have emerged in personal income taxation over time. A large part of personal income tax is collected as withholding tax on services, and for a large majority of taxpayers this is effectively a flat indirect tax. The upper tax slabs have received generous rate reductions in the hope that this will lead to an increase in tax filing and compliance. Personal wealth tax has also been zero-rated for the same purposes. The results with respect to tax coverage, however, have not been encouraging.

Overall, taxation has remained a relatively ineffective tool for influencing income or wealth distribution due to relatively small coverage, low compliance, and the large segments of the economy that remain undocumented. The low share of direct taxation in the national income underlines this weakness of taxation as a policy instrument.

Table-2

Trends in Taxation

	Tax to GDP ratio (%)	Share of Direct Tax in Total Tax (%)
2001-02	9.75	35.29
2002-03	10.12	31.60
2003-04	9.71	31.67
2004-05	9.64	30.97
2005-06	10.04	32.80
2006-07	10.17	38.19
2007-08	10.40	39.61

Sources: PRSP (various), Economic Survey (various)

Poverty-Reducing Expenditure

PRSP-I and associated progress reports identify public spending in a number of sectors and projects as "poverty-reducing".[8] This classification takes a broad view of poverty and is liberal in attributing a very wide range of spending as "poverty-reducing". There is no rigourous analysis behind the classification. The share of PRSP expenditure of federal and provincial governments as a proportion of total public spending rose from 20 per cent to 31 per cent between 2001-2002 and 2005-2006 (Table 3). Its share in GDP went up from 3.8 per cent to 5.6 per cent during the same period. The share of total public spending actually declined from 31 per cent to 28 per cent between 2005-2006 and 2006-2007.

Table-3

Share of PRSP Expenditure (Per Cent)

	Total Public Spending	GDP
2001-02	20.25	3.8
2002-03	23.22	4.32
2003-04	27.33	4.72
2004-05	28.31	4.83
2005-06	31.00	5.63
2006-07	27.64	5.71

Sources: PRSP (various), Economic Survey (various)

PRSP spending is dominated by five sectors – education, irrigation, law and order, roads, and health – which in 2006-2007 accounted for 86 per cent of expenditure. Spending in education, law and order, and health is dominated by current expenditures, mainly salaries and wages. The education budget includes spending on higher education. It is arguable if higher education and law and order are, indeed, poverty-reducing expenditures compared with say food support, child nutritional programmes or public works. Between 2001-2002 and 2006-2007 there was a shift away from the social sectors and in the direction of infrastructure. Large-scale projects such as national highways and dams (sometimes referred to as "mega projects") dominate the expenditures classified under "irrigation" and "roads, highways and bridges". There are questions here too about the efficiency of poverty reduction through large-scale capital intensive infrastructure compared with local infrastructure. In fact, the effects of some policy choices in infrastructure development might have been inequality-increasing.

8 This is in line with the Fiscal Responsibility and Debt Limitation Act 2005, which requires that 4.5 per cent of GDP must be spent on poverty-reduction expenditures.

Table-4
Sectoral Shares in PRSP Expenditures (Per Cent)

	01-02	02-03	03-04	04-05	05-06	06-07
Roads, highways & bridges	4	6	9	11	12	12
Water supply and sanitation	3	2	2	2	2	3
Education	40	38	37	37	39	33
Health	11	11	10	10	9	11
Population Planning	1	1	2	1	2	1
Social security & welfare	2	1	2	1	2	1
Natural calamities	0	0	0	0	4	1
Irrigation	6	7	9	12	14	15
Land reclamation	1	1	1	1	1	0
Rural development	7	8	7	5	3	4
Rural electrification	0	0	1	1	0	1
Food subsidies	3	5	3	2	1	1
Food support programme	1	1	1	1	1	1
Tawana Pakistan	0	0	0	0	0	0
Low cost housing	0	0	0	0	0	0
Administration of justice	1	1	1	1	1	1
Law and order	19	17	15	15	14	15
Total	100	100	100	100	100	100

Sources: PRSP (various)

The above analysis of fiscal trends does not take into account the possibilities for significant changes in allocations – both due to changed priorities and because of the imperatives of macroeconomic stabilization – in the current period. Some of the emerging policy directions were noted under "stabilization" above. The extent of change and its durability will become apparent over the course of the current (2008-2009) and subsequent fiscal cycles.

2.4 Targeting and Evaluation Mechanisms

Since the inequality of economic outcomes is not a distinct or explicit policy concern, there are no targeting mechanisms for ensuring that policy interventions achieve efficient inequality-reduction.

Poverty reduction, however, is an explicit goal of economic policy-making. Inspite of changes in nuance and emphasis from time to time, the basic poverty-reduction framework has remained fairly consistent over the last decade (if not longer)[9]. This framework can be characterised as operating at three distinct levels: macroeconomic management and economic reforms, broadly designated pro-poor government spending, and social protection measures. Mechanism for targeting and evaluation remain under-developed at all three levels.

9 This framework is widely shared within government, as shown above (with respect to the Ministry of Finance, the Ministry of Planning and Development, and the State Bank of Pakistan); and also by international development partners, as shown below.

Macroeconomic management and economic reforms:

It is assumed that prudent macroeconomic policies and market-oriented reforms are critical for ensuring high growth rates, which in turn are necessary for sustained poverty reduction. It is further assumed that macroeconomic and economic reform priorities have their own singular dynamics with few realistic policy options. This is one reason why we do not observe poverty or inequality impact analysis of alternative policy options in macroeconomic management and economic reforms. The absence of scenario-building with respect to poverty and inequality impacts of alternative policy options is a glaring omission, given that Pakistan has a strong tradition of collecting reliable household budget data needed to measure the micro impact of macroeconomic policies.[10] These data have facilitated ex post commentary but have not been used to any great extent for ex ante policy impact analysis.

Pro-poor government spending:

Poverty (or inequality) targeting is assumed to be effective at a very general level in identifying "poverty-reducing" public spending.[11] Entire sectors of the economy and line items in public expenditure are identified as poverty-reducing. The empirical or analytical basis for these judgments remains unclear. Some of these poverty-reducing (and possibly inequality-reducing) expenditures are more defensible than others – for example, social protection spending probably has a higher first-round impact on the poor than spending on law and order or on capital-intensive large-scale construction projects.

Social protection programmes:

There has been a tendency in the past to favour untargeted programmes over targeted ones on the plea that the government machinery necessary for effective targeting simply did not exist.[12] Untargeted food subsidies continue to be popular among some policy-makers. Targeted programmes – such as cash transfers or unemployment insurance in the form of workfare – have received relatively little attention in the past. The main cash transfer programmes until recently were Zakat and Bait-ul-Maal. With the complete takeover of contractors and sub-contractors, the idea of workfare has been abandoned in public works programmes. The Khushal Pakistan Programme - the flagship workfare programme until its replacement in 2008 by the People's Works Programme – was comprised almost entirely of small civil works projects that were contracted out, without placing any clear stipulation or monitoring mechanism related to employment generation.[13]

As an initial measure, it is possible to amend the rules of business of public works programmes to increase the possibility of labour monitoring of projects. Ultimately, there is a need to move towards workfare programmes that will have unemployment insurance as an explicit objective.[14]

10 This tradition goes back to the Household Integrated Economic Survey (HIES) data of the Federal Bureau of Statistics, which has been consistently improved and updated. Currently the Pakistan Social and Living Standards Measurement Survey (PSLM) data is regarded as a valuable resource. Another important source of post hoc evaluative data is the Multiple Indicator Cluster Survey (MICS).

11 This is the approach of the PRSP, as discussed above.

12 Untargeted consumer subsidies for food and energy have historically dwarfed targeted social protection transfers

13 Reported figures for number of person days of employment generated as a result of thee programmes are purely speculative.

14 Lessons from similar programmes such as the NREGA in India will be pertinent in this regard.

A review of the pre-existing targeted cash transfer programmes (Zakat and Bait-ul-Maal) indicates serious flaws and weaknesses.[15] Zakat is not targeted to the population on the basis of any criteria that will result in poverty or inequality reduction or amelioration. Instead, the targeting criteria are based on specific individual characteristics that are thought to have been used to target Zakat in 7th C Arabia. There are supposed to be Zakat Committees at the local community level that identify the beneficiaries. The programme is exclusively for Muslims, and widows, orphans and physically disabled persons are prioritized. Bait-ul-Maal is a citizenship-based entitlement which is supposed to be targeted to the poor and indigent. The selection process takes place at the district level, and no independently verifiable criteria are used for maintaining or updating the list of beneficiaries. There are two key flaws in the targeting mechanisms for Zakat and Bait-ul-Maal. First, neither programme is based on an explicit definition of a universe of potential recipients. In other words, there is no prior listing of all individuals or households from which some will be selected. Second, there is no way of ensuring that all potential beneficiaries are reached – the selection process is "top-down" in the sense that the selectors supply the list of a specified number of beneficiaries.

Renewed interest in social protection in the form of the Benazir Income Support Programme (BISP) and the Punjab Food Security Programme (FSP) has also raised questions about targeting. If public commitment to cash transfers is to increase several-fold, there is an opportunity for revamping targeting and implementation mechanisms to conform to desirable standards. Currently the BISP targeting and implementation mechanisms are under review, and it has been suggested that the scheme function on the basis of a universe – that is, to begin with, a list of all potential beneficiaries, or all people, within a specific territorial jurisdiction should be created. A proxy means test is being considered as a preferred method for targeting the poorest.[16]

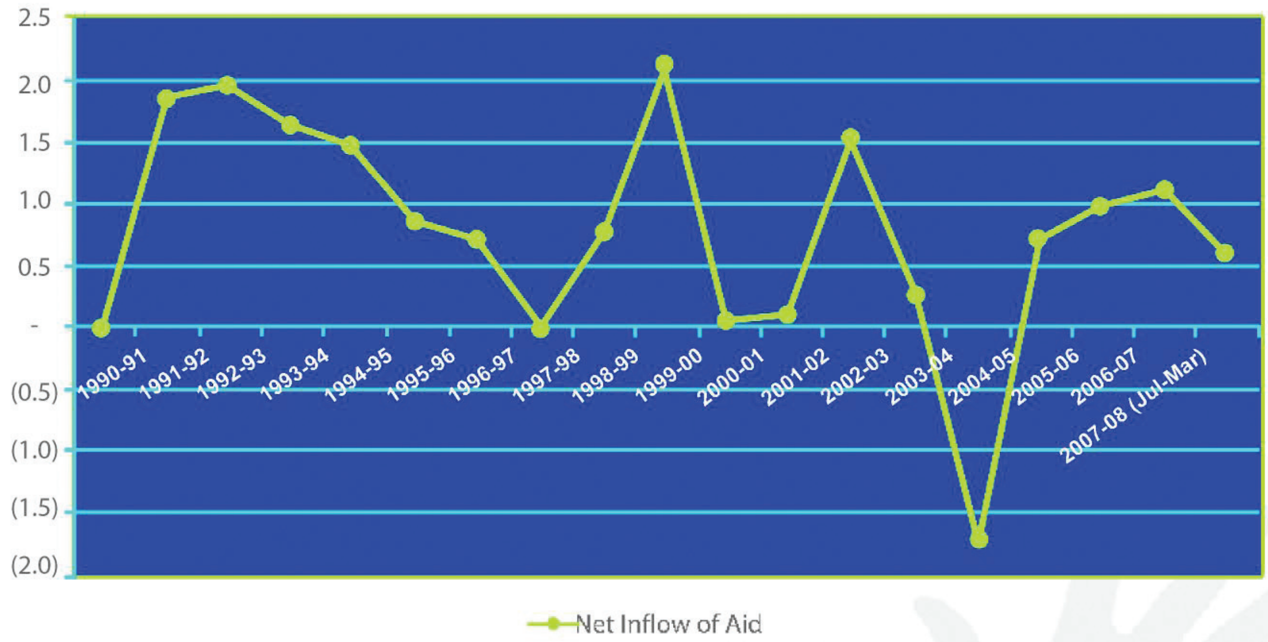
The Economists' Panel that made proposals for economic stabilization on the eve of the 2008 IMF programme recommended a major overhaul of targeting and implementation mechanisms at the local level. It floated the idea of the creation of a National Social Policy Platform across the country which could act as a targeting and monitoring agency working across social policy programmes.[17] These ideas have come in response to the identified gap in the governance structures of Pakistan whereby there is limited capacity at the local level to maintain and update population records and data on the service delivery, programme coverage and social exclusion. The investment of the government and the international development partners (see below) in the devolution process stopped short of creating reliable state machinery at the local (or Union Council) level.

15 These have been identified in detail in the work done for the National Social Protection Strategy 2007.
16 Briefings from BISP, World Bank Social Protection Team, October-December 2008.
17 Planning Commission (2008), Stabilization with a Human Face, Report of the Economists' Panel to the Prime Minister.

2.5 *Role of Development Partners*

Development partners have played a strategically important role in the direction of policy-making in Pakistan over the decades. Currently the country is undergoing an IMF-supported stabilization programme in response to unsustainable external balances. In the recent past too, the engagement of international development partners has coincided with key turning points in the economy. A rescheduling of foreign debt in 2001-2002 and the inflow of resources from international development partners led quickly to rapid private capital inflows. Although foreign aid inflows have been substantial, it is useful to track net inflows (disbursals minus total debt servicing) over time. Figure 1 shows that the net inflow of aid since 1990-91 has ranged from around (-1.5) per cent to 2 per cent of the GDP.

Figure-1
Net Inflow of Aid as % of GDP



Sources: Economic Survey 2007-2008

Policy documents of four influential international development partners – Asian Development Bank (ADB), World Bank, UK Department for International Development (DFID) and United Nations Development Programme (UNDP) – were reviewed to gain perspective about their priorities with respect to inequality.[18] The Asian Development Bank and the World Bank are respectively the largest and second-largest multilateral concessional lenders. [This is in terms of aid channeled through the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).] ADB lent a total of $2.1 billion and WB $1.2 billion in 2004-2005 and 2005-2006 (the last two years for which data were available). DFID grants since 1999-2000 totalled around $ 750 million, while UNDP grants in the same period summed up to around $125 million. All figures are based on data reported in Economic Survey 2007-2008. The following documents were reviewed:

- Asian Development Bank and Pakistan 2008: A Fact Sheet
- Asian Development Bank Country Strategy and Program Update 2006-2008
- DFID Pakistan Country Plan 2008-2013
- UNDP Country Programme Pakistan 2004-2008
- Government of Pakistan & UNDP Mid-Term Review of Country Programme 2004-2008
- World Bank Country Assistance Strategy 2006-2009

International development partners, like government, are primarily concerned with poverty reduction and the reduction in economic inequality as a means towards that end. Economic inequality is mentioned as a specific issue by the UNDP and the World Bank. UNDP links increasing inequality with the need to focus on "pro-poor growth", a term that is also used by ADB. The World Bank strategy highlights inequality in asset ownership and ineffective targeting of government programmes as reasons for the weak link between growth and poverty reduction in Pakistan.

The main focus of all four organizations is on poverty reduction. Starting in 2002, the ADB Country Strategy aimed to reduce poverty through supporting good governance, sustainable pro-poor growth (rural development and employment generation) and inclusive social development. Its approach was similar to that of the government in advocating poverty-reducing spending by the government. Although ADB took the lead in terms of financial support, all development partners focused their efforts on supporting devolved local government. Micro-finance also emerged as a common strategy. The poverty-reduction impact of these interventions has not been assessed. It is argued that devolution reforms will yield more inclusive social service delivery, but it is not clear if structural features of inequality have been addressed in these reforms.

18 The Asian Development Bank and the World Bank are respectively the largest and second-largest multilateral concessional lenders. [This is in terms of aid channeled through the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).] ADB lent a total of $2.1 billion and WB $1.2 billion in 2004-2005 and 2005-2006 (the last two years for which data were available). DFID grants since 1999-2000 totalled around $ 750 million, while UNDP grants in the same period summed up to around $125 million. All figures are based on data reported in Economic Survey 2007-2008.

A brief review of actual lending also reveals priorities other than inequality reduction. The ADB reported $973 million as the assistance pipeline for 2005. Over 40 per cent of this amount, however, was earmarked for a National Highways Development project. Another 15 per cent was budgetary support to a relatively well-off province, and over 7 per cent of the funds were for large cities. The ADB's Country Partnership Strategy of 2007-2011 continues with its support for devolution reforms, but also emphasizes the need for "balanced development" between rural and urban areas.

The World Bank's Country Assistance Strategy 2006-2009 is based on three pillars: growth, governance and social development and protection. Although all three pillars are claimed to contribute to poverty reduction, it is the third pillar that is actually supposed to address poverty issues directly. The first pillar, for example, lays great stress on economic reforms, a conducive investment climate and support to the financial sector. Its analysis of Pakistan's macroeconomic performance and the financial sector led growth model, however, failed to foresee issues in sustainability. The consequences for income distribution were also ignored. The second pillar continued the stress on devolution, as well as public-private partnership models of service delivery. It commended the now much discredited accountability courts. In addition, the strategy placed emphasis on supporting urban infrastructure – possibly accentuating the creeping urban bias engendered by the financial sector led growth model. The third pillar, which dealt directly with poverty reduction, focused mainly on the establishment of a comprehensive social protection system.

All development partners mention a number of areas of inequality of opportunity – gender-based inequalities in access to services, regional differences and rural-urban inequalities. Other structural inequalities such as those in land, labour and credit markets (discussed below) are dealt with in a simplistic manner. It is argued, for example, that helping poor people gain access to finance will allow them to set up their businesses.[19] The World Bank document argues for reforms in land administration without addressing the problem of previous failed reforms, and the prevailing social factors intervening in land ownership. It is also taken as given that labour market flexibility will improve opportunities for the poor, and a clear idea about the nature of constraints in the functioning of labour markets is missing. Some of these issues are taken up in more detail in Section 3 below.

Despite differences in their precise policies and scale of operations, some common features can be identified international development partners' approach to inequality. First, like the government, international developments partners regard inequality as a derivative policy concern of poverty reduction. Second, poverty reduction is seen as residual rather than integral to the overall design of economic policy – for instance, there is no attempt at making an explicit linkage between sectors prioritized for lending and poverty-reduction. Third, social protection is frequently mentioned as the key poverty-reduction strategy, but represents a small proportion of the funding.

19 DFID Country Plan 2008-2013.

3. Responses to Structural Inequality

3.1 Inequality of opportunity and structural inequality

There are three broad dimensions of inequality of economic opportunity. First, people living in some regions might be at a disadvantage due to remoteness, geographical conditions, and historical deprivation. Second, markets might be systematically loaded against some people because of their individual or group-specific characteristics. Third, there might be persistent inequalities within a locale in the availability and access to public services due to social and political discrimination. Inequality of economic opportunity will, obviously, translate into outcomes inequality such as the distribution of consumption, income or wealth.

But inequality of opportunity is not a necessary condition for distributional inequality. Even in an economy with perfectly equal opportunities some people will end up with more income than others due to a variety of factors. Many of these factors – such as trade-offs between labour and leisure, and consumption and savings – can be thought of as being choice-driven. Other factors might involve chance and fortune. If consumption, income or wealth inequality is mostly due to choice or chance the rationale for taking it up as a policy priority becomes weak.[20] Inequality of opportunity, however, is a more pressing and defensible policy concern under a wide range of conditions. Systematic disadvantages in access to infrastructure, markets, and public goods and services, need to be overcome on grounds of equal citizenship let alone poverty reduction and economic efficiency.

Table-5

Structural inequalities and policy responses

Structural inequality	Type of expected policy response
Gender	Affirmative action Legislation Tax/ subsidy design
Regional	Directed public investment Affirmative action
Economic class	Asset transfer (e.g. land reform) Contractual security (e.g. labour market reform)
Social identity including race, caste, ethnicity, religion	Affirmative action Protective action

20 There is still a strong rationale for protecting people from extremely low outcomes, even of those outcomes were due to choice or chance - hence social protection.

Policy responses to inequality of opportunity must focus on systemic and structural constraints rather than incidental ones. In other words, disadvantage faced by an individual due to idiosyncratic causes – for example, due to illness, absence of startup capital, or lack of a skill – does not in itself qualify as a concern of inequality reduction.[21] The individual in question will, in any case, qualify for social protection. If, however, an individual faces poor health due to the absence of a health facility, owns no assets due to historical social disadvantage, or lacks skills because of exclusion from schooling, there are structural inequalities behind his or her disadvantage. It is these structural inequalities that can be realistic and defensible policy concerns.

Four dimensions of structural inequality are conspicuous in Pakistan. These are (a) gender, (b) region (c) economic class, and (d) social identity. There are diverse social, historical, institutional, and geographic factors that underpin these various forms of structural inequality. The common factor is that these structural inequalities are resilient and require a range of policy responses besides fiscal ones. Table 2 summarizes the type of structural inequality and its expected policy response. The actual policy responses are reviewed below.

3.2 Gender

Gender inequalities are pervasive in all areas of life in Pakistan including education and health outcomes, access to services, and political participation. In the economic sphere, female labour force participation is much smaller than male.[22] Another pervasive feature of gender based economic inequality is in asset ownership. Women are far less likely to own land than men, and although inheritance laws require the division of property between sons and daughters, custom favours male heirs over females. There are barriers too, to effective control over property that women do actually own. Laws allow the holding of property in the name of a proxy (benami) and this is usually practiced with respect to women "nominal" owners.[23]

Gender inequality does receive attention in the social sphere – in education and health outcomes in particular.[24] Gender-based economic inequality, however, has not emerged as an important concern. This is despite the fact that there have been sporadic attempts at disaggregating economic data and policy impact by gender – for example through UNDP-supported exercises in the gender-tracking of budgets, and the Asian Development Bank's Gender Reform Action Plan (GRAP).

21 The individual in question will, in any case, qualify for social protection.

22 According to the Labour Force Survey 19 per cent of females and 70 per cent of males in the 15+ age group were in the workforce. Augmented data for women based on further probing questions doubles the female labour force participation rate to 40 per cent – mostly in unpaid family labour, and still far short of the male participation rate. There is parity, however, in male-female participation in the formal sector. 29 per cent of all non-agricultural female workers were in the formal sector compared with 28 per cent of male workers. (Labour Force Survey 2006-2007).

23 Reference – SDPI study?

24 This is a common finding across policy documents reviewed above.

Most economic data sources – national income accounts, government budgets, and household income, consumption and wealth statistics – fail to disaggregate by gender. There is an implicit assumption that resources are shared equally or without systematic biases between males and females, and thereof re overall aggregates provide reliable measures of well-being. Micro-level studies reveal that this assumption is not based on solid empirical evidence, and that intra-household gender inequalities can be severe.

A range of measures can respond to gender-based structural inequalities that inhibit women's economic opportunity. There is growing literature on the role that access to material resources – employment, social benefits, and asset ownership – can play an important role in the empowerment of women in society.[25] Pro-active policy initiatives in the labour market, social protection, and asset creation interventions can counter social and institutional biases against women.

There are already some ways in which government employment attempts to take affirmative action in favour of women workers. Women's employment quotas, however, have remained under-utilized for a variety of reasons. Some sectors, notably, the Lady Health Workers (LHW) are specifically targeted for women employees.[26] There are others, however, such as in the security forces which make up a large proportion of public formal sector employment where female formal sector participation is likely to remain miniscule

Creating women's entitlements to social protection is another important way for policy to influence intra-household dynamics. The stipulation in the Benazir Income Support Programme that the entitlement must be in the name of a female family member creates such an entitlement. This is a welcome first step that can be expanded in a more comprehensive way. There is a range of government programmes at the national and provincial levels where assets are transferred to beneficiary households – by default in the name of male heads of families. Some programmes have started to pay attention to nominating women as beneficiaries, and this idea needs to be developed and promoted.

Finally, there are some issues on which gender-based economic inequality will require legal and legislated redress. Property ownership and inheritance laws need to be come with tighter safeguards providing for effective control in the hands of women over their nominal property. Laws that allow proxy ownership also need to be reviewed.

25 See Ayesha Khan (2008), and the literature reviewed there

26 See Ayesha Khan (2008). There are over 100,000 LHWs, many of them being the first ever women in their families to have worked out of home. The LHWs, however, are formally regarded as honorary stipend holders and not employees.

3.3 Region

There are sharp regional differences in levels of development, economic opportunities and poverty. There are no "objective" criteria for policy action on regional inequality. Resource endowments between regions are bound to vary, and to the extent that economic opportunities are linked with resources these too will vary. Migration from resource-poor regions to resource-rich regions has been a continuous pattern in the livelihood strategies of communities.

Public investment in a region can and does change resource endowments. One of the most successful examples of regional uplift through public investment was the development of canal irrigation in the Indus floodplains. There are many other examples in contemporary Pakistan where public investment has led to regional development. Not all such investment, however, is necessarily efficient. There are limits on the extent to which regional development can be pursued in the face of adverse geographical conditions. It will be highly inefficient, for example, to invest public resources in building industries in a region that is far away from sources of inputs, labour and markets.

While acknowledging that no two regions will ever achieve exactly equal levels of economic potential, it is reasonable to expect that in some forms of infrastructure and public services citizens living across different types of regions should enjoy equal entitlements. The provision of health care, education, communication and access needs to be made available in remote as well as densely-populated regions. If some regions have a head-start in infrastructure development there must be catch-up public investments in other regions.

Regional inequalities have been captured in a number of ways. Data on a range of infrastructure and social development indicators have been used to generate district development or deprivation rankings.[27] These rankings show wide disparities between as well as within provinces. Punjab and Sindh turn out to be more developed for a range of indicators than Balochistan, NWFP and FATA. Within provinces there are important dualities. In Punjab, for example, there is a sharp divide between north-central parts of the province and its south.[28] In Sindh the main source of duality is the disparity between Karachi and the rest of the province.

There are several existing policy instruments for responding to regional inequalities. The most obvious one is budgetary allocations to provinces. Existing arrangements for allocating provincial revenues, however, do not give significant weight to the goal of balanced development. Balochistan and NWFP receive special grants in recognition of their special conditions, but there is no systematic method for either measuring backwardness or overcoming it using provincial allocations.[29]

27 See Social Policy and Development Centre Annual Review 2001.
28 This is confirmed in poverty analysis using MICS data that are representative at the district level – see Cheema (2008).
29 Based on discussion on NFC and other forms of provincial allocation in Economic Survey 2007-2008, and SPDC reports. For a review of NFC awards see Ahmed et al (2007), "National Finance Commission Awards in Pakistan: A Historical Perspective", PIDE Working Papers 2007:33.

Allocations within provinces to districts have been carried out using various criteria with different ways of dealing with "backwardness" in each province. Current allocations, in any case, are heavily determined by previous capital allocations.

Fiscal transfers to lower tiers of government – from federal to province, and province to district – represent only a relatively small part of total government spending. According to the ongoing National Finance Commission award only 46 per cent of the "divisible pool" can be allocated to the provinces. Federal government direct expenditures – current and capital – also have an impact on regional balances. If a federal government department's budget is dominated by wages and salaries, an understanding of regional balance requires consideration of where its employees reside or remit their salaries. Similarly, federally funded public investments are going to be located in some region – and hence will benefit that region without directly affecting the provincial budget. There is no systematic analysis yet of the overall impact of government spending of various types on regional balances.

Besides expenditure allocations, there are other ways too of influencing regional development. Tax breaks have been provided in various regions over time – for example, Nooriabad in Dadu, and the Hub industrial estate in Balochistan. There are proposals for setting up Reconstruction Opportunity Zones (ROZ) in NWFP and elsewhere. Government can also directly target individuals from backward regions through special quotas or affirmative action in educational institutions and government jobs.

International development partners have paid some attention to regional inequalities. Some of them, particularly the Asian Development Bank and the World Bank, have supported area development programmes that aim to target public investments in specific regions. In principle these regions are selected on grounds on under-development. In actual fact these organizations have not developed objective methods for regional targeting.

In summary, while regional inequality is a persistent structural feature of inequality in Pakistan, it has received only limited and ad hoc attention on the part of government and international development partners alike. The lack of agreement on objective regional development measures is only one indication of the low level of priority accorded to this issue.

3.4 Economic Class

Economic class can be entrenched as a form of structural inequality. If asset ownership is highly unequal, economic mobility can be constrained even under conditions of apparently open markets. Entrenched class inequalities, particularly in rural areas, are known to be impediments to equal citizenship, economic productivity, and poverty reduction not just in Pakistan but in most post-colonial countries.

In the early period after independence agrarian reforms were high on the policy agenda with the goal of addressing class inequality in rural society. Three types of land reforms were attempted with varying degrees of success: land redistribution, tenancy regulation, and allotment of homesteads to the landless poor. While the first two reforms have received a great deal of attention – and mostly thought to have succeeded very partially – the third reform is hardly recognized as a significant asset transfer in the policy debate. This omission is unfortunate, because the number of beneficiaries of this latter reform were among the poorest segment of the rural population, and are thought to have far outnumbered the beneficiaries of the other reforms.[30] All three types of land reforms, however, have remained inactive over the last twenty years or so. Their future potential needs to be reexamined.

Economic class inequality can also be addressed through addressing labour market disparities. Enabling legislation for collective action on the part of labourers, and effective arbitration mechanisms for labour disputes can enhance the bargaining position of the assetless poor. In a number of sectors such as agriculture, brick kilns and mining, bonded labour arrangements are extreme forms of inequality in labour markets. Pro-active policy on eradicating forced and bonded labour will form part of the policy framework of tackling class inequality

3.5 Social Identity

Social identity plays a crucial role in the functioning of formal and informal institutions in Pakistan. The labour market, for example, is not always anonymous and a person's identity can be an important determinant of opportunities. This is partly due to discrimination and partly because of the importance of personal reference and group-based collective action in contract enforcement. Studies of bonded labour have also revealed that a key common element among vulnerable workers is that they belong to historically marginalized groups that have relatively restricted access to political voice or state functionaries.[31] Identity of all types – based on caste, kinship, ethnicity, and religion – are important channels for organizing collective action, and hence exclusion from these networks can place an individual or group at a chronic disadvantage.[32]

30 See Gazdar (forthcoming) for details.
31 The ILO conducted a number of sectoral studies that came to this conclusion (reference).
32 See for example Gazdar (2006), and Mohmand and Gazdar (2006) for a nationwide study based on village surveys in eight sites.

There is very little public or official acknowledgment in Pakistan of social identity as a source of marginalization and economic inequality. Some supposedly pro-poor programmes – such as land allotment – continue to actively discriminate against the socially marginalized. The provincial land allotment rules in Punjab, for example, state that land can be allotted to recognized cultivators who happen to be landless. This rules out, at a stroke, all those "subservient" castes that are not recognized as "cultivators" by the provincial land revenue system. Comparative experience suggests that social marginalization based on race, caste or other forms of social identity can be challenged through proactive measures for ensuring inclusion. There are few interventions in Pakistan that recognize, let alone actively confront, these forms of marginalization and exclusion.

4. Findings and Recommendations

Economic inequality can be classified into two types – inequality of economic outcomes, and inequality of economic opportunity. These two types of economic inequality have their own respective counterparts in the policy discourse. Distributional inequality, operationalized using statistical measures such as the Gini coefficient, deals with the inequality of economic outcomes. The inequality of economic opportunity is examined with respect to structural inequalities based on gender, region, economic class and social identity.

4.1 Distributional Inequality

Distributional inequality does not emerge as a policy concern in its own right in Pakistan. A review of government policy documents as well as the stated priorities of Pakistan's international development partners confirms that concern about inequality is, at best, derivative of the goal of poverty reduction. This absence of an explicit focus on inequality reduction as a policy objective is neither surprising nor unique to Pakistan.

Distributional inequality not an explicit policy concern

Inequality reduction becomes a conspicuous issue in the policy debate only during or after periods when high economic growth did not lead to rapid poverty-reduction. There have been two clear periods in Pakistan's economic history – 1960s and 2001-2007 – when inequality emerged as a concern precisely because of the perception that growth had not delivered adequate poverty reduction. Because inequality reduction is not an explicit policy goal, it is often raised as an issue only after a particular round of economic growth has failed to deliver rapid poverty reduction.

Macroeconomic management and economic reform priorities not linked with poverty or inequality reduction

There has been a broad consensus in the framework of economic policy-making – in macroeconomic management and with respect to reform priorities – around fiscal prudence, conservative monetary policy, inflation-targeting, privatization, external openness and market-orientation. While this consensus has not always translated into coherent policy actions, it has defined the broad parameters within which inequality-reduction policies have been considered.

In particular, hardly any attention has been paid, *ex ante*, on the poverty or inequality impacts of macroeconomic management and economic reform policies. This follows from a mistaken understanding that the existing consensus on economic policy positions exhausts all possible alternatives. Since no alternatives are admitted there is little practical reason for scenario-building or modelling the likely poverty or inequality impact of alternative policies. In fact, alternative positions are available in macroeconomic management and economic reforms, and *ex ante* poverty and inequality impact analysis of alternative scenarios must be an integral part of macroeconomic management and economic reforms.

Taxation weak instrument for redistribution

The policy instruments available for affecting distributional inequality have been relatively weak, and have not strengthened over time. Taxes have remained stagnant as a proportion of national income, and direct taxes account for only around 4 per cent of the GDP.

Weak link between "poverty-focussed" expenditures and poverty reduction

The PRSP process has led the government to identifying a number of expenditures as poverty-reducing. There is also a commitment to ensuring that allocation to these heads remains above a certain proportion of the GDP. Many of the expenditures identified as part of the PRSP, however, seem not to have a direct linkage with poverty or inequality reduction.

Targeting and implementation mechanism key constraint in social protection

Social protection allocations have increased significantly in the current fiscal year, but targeting and implementation mechanisms remain weak.

Ex ante policy focus on inequality is necessary for effective poverty reduction

The absence of inequality reduction as an explicit policy concern – and the focus instead on growth and poverty reduction – appears understandable at first sight. After all, if poverty is being reduced at a reasonable pace increases in inequality need not signal a problem from the welfare or efficiency points of view. While this understanding is valid *ex post* – that is, it is correct to focus on poverty reduction rather than inequality retrospectively – it does not carry through to the *ex ante* perspective.

Poverty reduction is actually a consequence of sufficient growth in the consumption or income of those below the poverty line and no corresponding declines in incomes above the poverty line. It is difficult to predict the effect of policies and economic changes on poverty without making assumptions about distribution. In other words, policy choices must be informed by their impact on growth and distribution, even if the outcome of interest is poverty reduction. Inequality, however, becomes a policy concern typically only after the impact has already been experienced. There is, therefore, need for inequality to be built in as an explicit concern at the time when policy choices are being made, particularly during a period of economic recovery and growth. In conjunction with adequate *ex ante* consideration for social protection, a focus on inequality must be part of an effective poverty reduction strategy.

4.2 Structural Inequality

There are strong reasons for pro-active policy measures to counter structural inequalities that lead inequality of opportunity. Structural inequalities are correlated with geographical and historical patterns of deprivation, market segmentation, and unequal access to public services. There are four key dimensions of structural inequality in Pakistan: (a) gender, (b) region, (c) economic class, and (d) social identity. These forms of inequality are structural because they represent vicious circles of poverty and inequality.

Markets do not provide simple solutions to structural inequalities. Rather, in the absence of pro-active policy initiatives, markets are likely to reproduce existing geographical, historical and social inequalities.

Gender

Gender inequalities receive attention in government and international development partners' policy priorities with respect to social outcomes in education and health. There is very little policy focus on economic aspects of gender inequality. Issues such as women's ownership of property, gender discrimination in labour markets, constraints to greater female labour force participation, and the linkage between economic opportunities and women's empowerment have not appeared as important ones in economic policy-making. Despite some efforts there remains an implicit assumption that economic policies are gender-neutral. The household is regarded as an adequate unit of welfare measurement, thus reinforcing the assumption that intra-household inequalities need not concern policy-makers. The government's role as a potential factor in challenging patriarchal social relations – say, through affirmative action in government employment -- remains seriously under-utilized.

Region

Resource allocation on the part of government as well as international development partners is only weakly responsive to the problem of long-term regional inequalities in the provision of infrastructural, social services and economic opportunities. Consistent or systematic analysis of regional disparities does not form an integral part of the policy-making process. Ad hoc measures targeting regional inequalities – such as one-off grants and investments - can provide some amelioration but are not enough. Balanced regional development needs to be rigourously incorporated as a goal of economic policy.

Economic class

Structural inequalities based on economic class received some attention in the early period following independence and up to the 1970s. Land reforms were carried out with the goal of altering agrarian class structures, and creating openings for poor cultivators. Other measures such as the allotment of homestead land to labouring classes and the regularization of urban squatter settlements transferred assets to those near the bottom of the class hierarchy – landless labourers and migrant workers. Slow growth in employment opportunities and the decline in public schooling tends to entrench inter-generational class inequalities. The recent period has seen an informalization of the labour market without a corresponding expansion in high quality jobs. Alongside labour market deregulation these developments have considerably reduced the economic bargaining power of some of the most deprived segments of the population. There is need for an reassessment of further labour market deregulation, informalization, and the potential for asset transfer programmes such as homestead land grants and settlement regularization.

Social identity

Inequality and hierarchy based on social identity – race, caste, ethnicity, kinship group, religion and sect – is a pervasive feature of the economy that remains virtually invisible in the policy discourse. Access to markets as well as public services and political resources is highly segmented by social identity and these inequalities will continue to be reproduced in the absence of pro-active political and policy initiatives.

4.3 Recommendations

(i) Explicit focus on inequality

There must be an explicit focus on distributional inequality in economic policy-making. This does not necessarily mean that inequality <u>reduction</u> will be a policy objectives at all times. It is possible that policy makers will commit to keeping the distribution constant, or even allowing for modest increases in distributional inequality, if there are compensating gains for growth that will lead to an overall reduction in poverty. But it is important that policy-makers specify the combinations of growth and redistribution they envisage in order to attain their targets of poverty reduction. Poverty reduction must be understood explicitly as a consequence of growth and redistribution.

(ii) Macroeconomic management and economic reforms

Macroeconomic management and economic reform policy choices must be subjected, *ex ante*, to rigourous poverty and inequality impact analyses. Poverty and inequality impact analysis using formal modelling tools should be introduced in the Ministry of Finance, Planning and Development Department, and the State Bank of Pakistan.

(iii) Regional statistics

The Planning and Development Department should develop spatial analysis of poverty and development down to the sub-district level as an integral tool for public investment allocation. International development partners should also use consistent criteria for their support for regional development projects. Spatial data on poverty and development should be updated regularly. Government must take the lead in establishing objective and officially-owned regional and sub-regional rankings, and poverty and development scores, which might be used for channelling regional resource allocations.

(iv) Gender disaggregated policy impacts

The Ministry of Finance and the Planning and Development Department must take forward the work done on gender budgeting and institutionalize gender-disaggregated policy impact analysis across the range of policies.

(v) Focus on social identity

The policy and research discourse should be encouraged to address social identity as a determinant of structural inequality. Given the current policy-invisibility of this issue it will be important in the first instance to simply increase its visibility through commissioning qualitative and quantitative empirical research on various dimensions of social identity and its impact on the functioning of markets (particularly labour, credit and land), and access to public goods and services. Specific attention should be paid in these studies to issues relating to race, caste, kinship group, ethnicity, religious and sect, in the processes of social marginalization. Research findings must be presented and debated at policy and opinion-making forums including various levels of government, parliament, media, and civil society platforms.

(vi) Taxation

The Finance Ministry must move towards the expansion of the tax base, increasing reliance on direct taxes, and introduce progressive scales in taxation.

(vii) Poverty Reduction Strategy Paper

The PRSP should carry out rigourous analysis of the poverty impact of different elements of government spending. The classification of sectors as "poverty-reducing" needs to be augmented by more systematic analysis of the relative efficiency of poverty reduction across sectors and sub-sectors.

(viii) Targeting and implementation mechanisms for social protection

Social protection targeting and implementation mechanisms need to be greatly enhanced. The Planning and Development Department should work with ministries and departments concerned with social policy issues (e.g social welfare, education, health) and with sub-national governments to institutionalize a system for targeting and implementation at the local level. Targeting and implementation systems must have three key components: (a) work at the level of designated and compact territorial units (e.g Union Councils), (b) be based on the concept of a universe that includes all residents of the relevant territorial unit (c) use pro-active measures (e.g. house to house census, information campaigns, special attention to socially marginalized groups) to ensure coverage and outreach.

(ix) Asset transfer as social protection

Schemes for asset transfers such as the allotment of agricultural land, and more importantly, homestead plots for rural labourers need to be reviewed and revived. Existing schemes for the use of state land for the regularization of irregular settlements in urban areas should be reviewed and expanded. Asset transfers to the poor need to be carried out within the framework of transformative social protection.

(x) Affirmative action

Affirmative action in favour of groups facing inequality of opportunity must be instituted or significantly enhanced. Three types of groups stand out as potential beneficiaries of affirmative action: women, people from regions and sub-regions identified as being particularly deprived, and individuals from socially marginalized groups as identified through a process of research and consultation. There are three types of resources where affirmative action can be effective. (a) government employment, (b) educational opportunities, including special scholarships in private institutions, (c) asset transfers such as agricultural and homestead land. The latter is already supposed to be targeted to the poor, but should, additionally be used to create property rights for women.

(xi) Legal and judicial processes

A range of non-fiscal measures are available and required for addressing structural inequalities. These include: (a) legal changes that allow collective action on the part of workers in the informal sector, (b) effective tenancy and labour adjudication and labour contract enforcement, and (c) pro-active measures to combat bonded labour.

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