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USAID/PAKISTAN

PROGRAM WEEK

MAY 1988 ACTION PLAN

BEST AVAILABLE

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I. INTRODUCTION

The economic and developmental concerns described in last year's CDSS remain intact. If anything, the critical issues discussed there have become more sharply defined. In the "national debate" surrounding the "leaked" CDSS document last summer, few if any commentators disagreed with the USAID assessment of the basic problems facing Pakistan over the next five years. Early drafts of the Seventh Five Year Plan reflect similar concerns. Domestic resource mobilization in particular is a recurring concern, both throughout the CDSS and in the Seventh Plan. The success of the Plan undoubtedly hinges to a great extent on how this issue is addressed.

At the same time, the political environment since the last CDSS has changed dramatically. Despite continuing uncertainty, the signing of the Geneva Peace Accords on April 14 will have a significant impact on future developments in Pakistan. Questions surrounding the return of the Afghan refugees and the ultimate composition of a "post Soviet" Kabul government loom large before us and Pakistan. Regardless of what happens, evidence of United States constancy will be a central factor in determining United States-Pakistan relations and will undoubtedly have an impact on events in neighboring Afghanistan. The economic assistance program is understandably viewed by Pakistan as one of the most important indicators of the nature and extent of United States commitment during a time of uncertainty and possible hardship.

The discussion that follows emphasizes domestic resource mobilization as the central economic policy issue facing Pakistan over the next five years. The Geneva Accords are also introduced and discussed as an important political change affecting the aid program in Pakistan. The six documents requested by AID/W at the last CDSS review and provided by the Mission in recent months (National Integration Strategy, Energy Strategy, Amplification of Agricultural Sector Strategy, Cash Transfer Paper, Domestic Resource Mobilization Paper, Benchmark Review) are not all specifically mentioned in the narrative. However, they are referenced in Annex A and can be discussed if requested at individual meetings during Program Week.

II. STRATEGIC CONCERNS

A. Policy Dialogue

Domestic resource mobilization, identified as one of ten key "problem" areas in last year's CDSS, has emerged as the critical developmental problem facing Pakistan over the short-term. It has also become the most pressing issue on our--and the multilateral development institutions'--policy dialogue agenda with the GOP, coloring a spectrum of issues from user charges to reduced subsidies to private sector promotion. GOP responsiveness on these issues is directly linked to the difficulty it faces in raising needed revenue and providing needed services.

The problems are clear enough. The budget deficit grew at an annual rate of 45 percent between 1980 and 1987 as total revenues only grew at a rate of 17 percent compared to 30 percent for expenditures. The budget deficit rose to 8.9 percent of GDP in 1986-1987, from an acceptable 5.3 percent in 1980-1981. Financing the growing national debt is increasingly a problem, adding to the gravity of an already deteriorating physical infrastructure and traditionally poor support for the social sectors. It is no accident that GOP took heretofore "unthinkable" steps such as seeking private sector investment in power generation and expanding its limited NGO promotion activities at a time when it is increasingly clear that the government itself is unable to provide needed services. At the same time, this push for more realistic financing options is held back by real political constraints inherent in a government facing elections.

Most of the indicators established in the CDSS--tax reform, inauguration of private investment companies, and movement of public sector entities such as WAPDA and the Oil and Gas Development Corporation (OGDC) off-budget--will be worked out in the course of the Seventh Five Year Plan. All three of these indicators figure as announced policy goals, though implementation historically has a tendency to lag. User charges, resulting in a simultaneous reduction in subsidies, constitute another area where progress has been made but much more still needs to be accomplished.

The list of cross-cutting policy dialogue concerns resulting from this issue is neither long nor surprising:

- Subsidies: About one-third of the wheat subsidy has been eliminated, due in part to studies sponsored by USAID. The situation for fertilizer has also improved. Our program will attempt to support GOP efforts to eliminate the remaining subsidy on wheat consumption and continue to work toward further reductions in the fertilizer subsidy.

- User Charges: USAID together with other donors has been encouraging the government to implement tariff structures for electricity, gas and irrigation that are more in line with actual economic costs. These changes will not occur overnight, but our major sector goals for energy and agriculture expect substantial progress over the next several years.

- Reduced Government Expenditure: Government expenditure patterns are severely constrained by debt repayment, defense, and grants to provinces, which together account for four-fifths of Pakistan's annual current budget. Nevertheless, there are some areas where costs can definitely be cut. One of the most promising options, frequently raised in policy dialogue discussions and anticipated under the Seventh Plan, is to move major public sector agencies such as OGDC and the Telephone and Telegraph (T&T) Department off-budget.

• Private Sector Promotion: Private sector promotion has certain attractions for an election-conscious government reluctant to make large waves with dramatic new taxation or user charge programs. Acceptance of the idea of private sector power is an important step, but needs continuing support. Windows of opportunity in a range of other areas, including agriculture, child survival, transport, and housing figure prominently in our overall policy dialogue agenda with the GOP. Private banks and investment companies are also much needed.

Taken together, these items form the heart of our policy dialogue across sectors and are likely to continue to do so for the foreseeable future.

B. Donor Coordination

Donor coordination occurs frequently at both the operational and policy level, especially in connection with the multilaterals (World Bank and Asian Development Bank) which each contribute about $600 million annually to Pakistan. This cooperation extends to the smaller United Nations agencies and most bilateral donors. Donor coordination with Japan, at $250 million annually the "other" major bilateral donor, is more problematic, though we are trying to hold more frequent consultations and improve their understanding of the policy concerns we consider vital for Pakistan's development.

Formal coordination meetings involving the multilaterals as well as bilateral donors take place in energy, irrigation, agriculture, health, population and narcotics control. Most recently, a forum of donors in WID has been activated to exchange information and coordinate activities. Such meetings occur not only to exchange operational and technical concerns but also to reinforce and if possible work out a common approach on major policy dialogue issues. In particular, the multilaterals share and support our view on a range of domestic resource mobilization issues.

The record of donor coordination in energy is especially noteworthy. USAID has held meetings with the World Bank in both Islamabad and Washington to coordinate the evolution and development of the Private Power Project at regular intervals over the past twelve months. The Asian Development Bank has been closely consulted here and in Manila also. Approaches to electricity tariff rationalization and revision of the Rural Electrification Master Plan due this summer were worked out together. Similarly, USAID and the multilaterals together have been working to urge policy reform in such areas as self-financing for the Oil and Gas Development Corporation (OGDC) and improved pricing and petroleum concessions aimed at attracting foreign investment. Careful ADB-USAID coordination led to an important decision last fall to permit natural gas to be an eligible fuel for private power generation, with special attention to the use of low BTU, low pressure gas fields.

USAID and the World Bank are co-financing a major program in irrigation, including support for policy initiatives on O&M and water user charges. Donors active in irrigation hold biannual coordinating meetings, an activity initiated by USAID some time ago. In the area of food security management, the Asian Development Bank is reinforcing a USAID policy stance in connection with its own $50 million wheat storage project which supports a pricing policy covering storage costs and an O&M policy ensuring proper maintenance. The activity also promotes private sector participation in grain storage, handling, and transport.

Donor coordination extends to the social sectors. Joint USAID, CIDA, UNICEF, and WHO support for Pakistan's national immunization program will continue through the USAID Child Survival project to begin this year. A similar collaborative agreement is being developed for oral rehydration therapy. An ongoing dialogue is also continuing on ordering priorities in health to ensure that more cost-effective preventive health care approaches are given highest priority. This may have to become even more focused if the Seventh Plan reflects a shift in resources toward "bricks and mortar" and employment for doctors to the detriment of operational child survival activities. In recent years, a number of donors have expressed interest in supporting initiatives in primary education. USAID also plans to become involved, most likely in a program emphasizing improved female education in rural areas.

Finally, the Mission is working closely with other bilateral donors as well as the United Nations Fund for Drug Abuse Control (UNFDAC) in the area of narcotics control. The Mission provided $10 million for an UNFDAC project designed to support the eradication of opium poppy cultivation in Dir. Other donors to this project include the British, Dutch, Canadians, and Italians. Mission (and A.I.D.) funding is also helping to establish a Drug Abuse Prevention Resource Center in cooperation with UNFDAC and the Embassy's Narcotics Affairs Unit. More broadly, the bilateral donors meet on a periodic basis under UNFDAC auspices to review progress in eradicating opium poppy cultivation.

C. Geneva Accords

The Geneva Accords represent the one significant political change over the last twelve months. Though talks had dragged on for years, the Soviet announcement that its troops would actually be withdrawn and the formal signing of the Geneva Accords on April 14 stand as an unprecedented shift that will have a dramatic impact on Pakistan. The agreements themselves represents a start rather than the conclusion of a process determining the status of post-war Afghanistan. Pakistan will remain an important part of that equation but will likely face continuing pressure from Kabul.

The ultimate success of the Geneva Accords is still problematic and much uncertainty continues to surround actual implementation. From Pakistan's point of view, the central question is when the refugees will actually return home. Pakistan is also acutely sensitive to any signals from Washington on what signing of the agreement may mean in terms of the level and commitment of continued U.S. support.

In the wake of the settlement, Pakistan will have to confront a broad array of problems, the dimensions of which are only now being realized. A massive repatriation effort is being planned. Considerable infrastructure will have to be reconstructed in the areas surrounding dense refugee concentrations. The degraded environment--fields, forests, water--have to be restored. Economic adjustments will need to be made in agriculture, trade and transportation, where refugees played an important role. Over ten thousand GOP employees whose jobs were based on the presence of refugees may now face unemployment, along with the many Pakistanis employed in business associated with the presence of refugees. Finally, many Pakistanis are aware that in many instances the Afghans were provided more services than indigenous residents. Health, education, and infrastructure investments are especially needed in areas of the NWFP, Baluchistan, and Punjab affected by refugees.

USAID is prepared to work toward meeting these needs, and strongly believes that at the very least the $30 million cut from this year's OYB for Pakistan should be restored in FY1989 or FY1990. In any case, our Tribal Areas Development Project (TADP) is well-placed to address some concerns related to the departure of refugees; the TADP evaluation planned for this fall will specifically address how this might be done.

D. Resource Requirements

The most compelling argument for continuing assistance at current levels is that in March 1986 the Administration, subject to Congressional approval, committed itself to providing $2.28 billion in economic aid to Pakistan during the FY1988-FY1993 period, $1.8 billion in grant assistance and $480 million under the PL 480 program. The CDSS and subsequent planning and programming documents have been developed with those figures in mind. GOP planning also takes place with the expectation that the United States will in fact deliver on its commitments. Already the $30 million ESF cut in FY1988 has caused programming difficulties, in this case in meeting wheat import requirements caused by unexpectedly poor winter rains.

A strong case can be made that the Pakistan program is unique in its political and national security objectives. Neither Egypt nor Philippines is comparable. The principled stand taken by Pakistan on Afghanistan is being vindicated and has historic significance. Nowhere else has a government opened its borders to three million refugees, provided a conduit for support to freedom fighters leading to the apparent defeat of a superpower, and transferred power peaceably to a civilian government. This unique effort deserves our continued high level support.

The key issue has been and will remain U.S. constancy in its long-term commitment to Pakistan. This was the fundamental reason why the U.S. government made a long-term commitment to Pakistan in 1981 and again in 1986. Given continued uncertainty over Afghanistan, the GOP is extremely nervous about future aid levels and highly sensitive about any signs of diminished U.S. commitment and resolve. Shortfalls in one fiscal year under the previous program were subsequently "made up" by higher funding levels in later years. Our programming levels for FY1989 equal those established in March 1986--$300 million ESF/DA; $80 million PL-480. We will continue to make a case for meeting our prior commitments, including recovering the amount anticipated in FY1988 but not delivered.

III. PERFORMANCE INDICATORS AND EVALUATION

A. Evaluation Strategy:

Almost half the portfolio has been evaluated since the CDSS/Action Plan review last May. This includes six evaluations from FY1987 (CIP Programs in Energy and Agriculture, Gadoon, Forestry, Malaria, and NWFP Agriculture University) and three so far this fiscal year (Baluchistan Area Development, Irrigation, and Food Security Management), with another three either planned or underway (Agriculture Research, Social Marketing of Contraceptives, and Energy Planning and Development). Some of these evaluations--in particular the joint review of the energy and agricultural commodity import programs--have not been ordinary project evaluations but represent a major review of key initiatives with important implications for the FY1988-FY1993 period. Finally, the recent assessment of the FY1982-FY1987 program provides a "historical" overview of the entire six-year period which should prove useful as an "institutional memory" document for many years to come.

As first-time evaluations, most of those undertaken thus far have focused more on "process" than on "impact." As the overall program review emphasizes, many of the activities initiated during the FY1982-FY1987 period are only now starting to have impact. First-time evaluations tend to focus more on the mechanics of implementation--institutional relationships, effectiveness of technical assistance, arrival of commodities, processing of trainees, etc. It is "second generation" evaluations that should be able to tell a more complete story in terms of how project activities have affected planned beneficiaries.

The Development Support Training evaluation scheduled for next fall is one example of a planned "impact" evaluation. Lasting four months, it will include tracer studies to follow-up how some of the thousands of participants during the past six years have benefited from training programs. AID/W has been asked to assist in drafting the SOW for the evaluation. Given the importance the Mission attaches to training, this project evaluation should very much be considered a "cornerstone" for our program.

Agriculture is another "cornerstone" area. By the end of this year, all projects in that sector will have been evaluated within an 18-month period. Taken together, these evaluations provide a comprehensive overview of institutional development issues and a list of recommendations at roughly the <u>start</u> of the CDSS period. In addition, research activities recently undertaken (poultry industry study, dairy study, maize and economic studies, development of more accurate and timely data through the Food Security Management project, etc.) provide continuing guidance for program development, policy discussions, and implementation.

The timing of project evaluations has generally been good. Although the evaluation schedule has been heavy in recent years, it does not reflect an "evaluation for evaluation sake" approach. In most instances, evaluations have been linked specifically to major decision points on proposed amendments or redesigns. In the upcoming Tribal Areas Development evaluation, this link is made very explicit. In some cases (e.g. the upcoming review of the Command Water Management (CWM) portion of the Irrigation Systems Management project) an evaluation is needed for an important "pilot" activity involving the World Bank and USAID to address the innovative institutional differences between CWM and the traditional On-Farm Water Management approach.

FY1989 should provide somewhat of a "breathing space" in terms of numbers of evaluations, with possibly three rather than seven or eight planned. It should also provide an opportunity to more fully assess and if necessary modify the CDSS-linked indicators established over the last several months. Finally, the Mission is considering hosting an evaluation workshop along the lines of what has been done previously in Cairo and Dhaka to broaden the Mission's information systems and provide greater input into program and policy decisions.

B. Impact Assessment:

Revised indicators linked to the CDSS were sent to AID/W in January 1988. Highlights of more significant developments in each of the ten key areas established in the CDSS over the last twelve months are provided below. A longer annotated version of that document is attached providing further details on progress to date.

Domestic Resource Mobilization: Major domestic resource mobilization concerns are discussed at length in the earlier section on strategic concerns. As noted there, domestic resource mobilization is a cross-cutting issue that underlines our policy dialogue in many sectors. The indicators selected relate to policy reforms and macro indicators in the Pakistani economy which our program affects, albeit not necessarily directly.

Balance of Payments: Pakistan's balance of payments position improved quite dramatically last year, though it is debatable how much of that progress is due to policy reforms announced last year and how much is attributable to external factors such as an extraordinarily good cotton crop. Exports increased by 19 percent between 1985-1986 and 1986-1987 (from 2.9 billion to 3.5 billion). The trade deficit declined by 23 percent during the same period (from \$3 billion to \$2.3 billion).

Agricultural Productivity: CDSS indicators here relate mainly to long-term goals in the agricultural sector promoted by--but not necessarily linked directly to--the Agricultural Sector Support Program (ASSP). It is too early to establish long-term trends in terms of productivity in key crops. The poor wheat and maize harvest this year is offset to some extent by the excellent cotton crop. In wheat storage, the GOP has met CPs to make PASSCO responsible for the O&M of storage facilities and change the system of O&M funding to ensure adequate funds.

The fertilizer subsidy is gradually being reduced and should be eliminated by 1992. The ASSP policy benchmark for this year is to increase the price of DAP by 10 percent, thus reducing the subsidy by an equal amount. The end of project target is complete elimination of the subsidy, a goal which has consistently been maintained by GOP officials in various meetings. However, the recently released "Report of the National Commission on Agriculture" recommends continuation of fertilizer subsidies, a major disappointment.

Policy success in increasing provincial budgetary allocations to irrigation O&M actually lowered the proportion financed through water users charges from 53 percent in 1983 to about 38 percent in 1987. Nevertheless, the 100 percent goal for 1993 is still attainable as public tubewells are privatized and hence excluded from O&M costs. GOP budget shortfalls this year damaged institutional reform efforts relating to increasing operating costs relative to salaries, underscoring yet again the impact of the resource mobilization failure throughout the economy.

Energy Deficit: Although load shedding has been more manageable this past year, the enormous investments needed to keep pace with Pakistan's growing energy demand figure prominently as part of the draft Seventh Five Year Plan. A modest increase of 200 MW in power generating capacity (from the USAID/ADB co-financed power plant at Guddu) is expected this year, adding to Pakistan's existing capacity of about 6,500 MW. One letter of intent for a 130 MW private power plant has been signed, negotiations for at least two other private sector projects are in progress, and the GOP Economic Coordinating Council (ECC) has authorized a letter of intent for a 1,300 MW project.

Although considerable effort is now being expended on this promising new private power initiative, it will be some time before such ventures begin meeting Pakistan's energy needs. Steady increases in electricity tariffs are needed to both fund WAPDA's own expansion, and encourage more private sector projects. The 16 percent average increase in electricity tariffs last summer should be followed by additional increases this July. The World Bank energy sector loan calls for WAPDA to set rates sufficiently high to generate revenues that will be adequate to finance 40 percent of a specified investment program. Remaining to be tackled is reform of the flat tubewell tariff and introduction of peak load pricing in industry. GOP acceptance this summer of a revised Rural Electrification Master Plan featuring socio-economic criteria for village selection will likely lead to USAID involvement in actual expansion of the rural electrification system in FY1989.

Although USAID is less directly involved in the oil and gas sub-sector, private sector firms--most notably those from the United States--are leading to steady increases in Pakistan's domestic oil production. Current production is up to 50,000 barrels a day, twice that envisaged by the end of the Sixth Plan. USAID sponsorship of the recent National Oil and Gas Symposium in Islamabad has helped accelerate private petroleum concession agreements and the preparation of a new petroleum policy.

Population Growth: There continues to be considerable debate within the GOP on the true rate of Pakistan's population growth. The Seventh Five Year Plan uses the figure of 3.1 percent. Other indicators relating to access to family planning services, the role played by the private sector, and fertility rates have not changed measurably from when the CDSS was written. Public sector contraceptive off-takes in 1987 were an encouraging one-third higher than in 1986. Survey and data-gathering exercises that will provide more information on this in the next couple of years include a demographic and health survey which will measure contraceptive prevalence.

Infant Mortality: Estimates of infant mortality in Pakistan vary widely, from 80 per 1,000 to 115 per 1,000. USAID and UNICEF believe it is around 100 per 1,000. Surveys and improvements in health information systems planned as part of the Child Survival Project should help obtain better data. Interim indicators are somewhat encouraging, in particular a March 1988 WHO-sponsored survey which indicated that 81 percent of one to two year olds were fully immunized; the ORS use rate in case of diarrhea was over 50 percent; and tetanus toxoid coverage of women since 1986 had doubled to 40 percent. The impact on infant mortality of these figures is likely to be significant if sustained. However, there are concerns about resource allocation to primary health care under the Seventh Plan. If political pressures for construction of facilities and employment of doctors result in underfunding of high-impact preventive and child survival programs, we will have a major policy issue on our hands.

Primary Education: Specific "impact" indicators have not yet been established for primary education but will be proposed during project design and development. The PID is tentatively scheduled for completion during September/October 1988. The GOP record of financial support for primary education in the past couple of years has been quite good. Overall literacy rates are still at an appalling 27 percent, and are much lower for women and in rural areas.

Institutional Improvements: Progress in attaining training goals established as a CDSS benchmark is going well, but has been slowed by lagging nominations from the GOP and new medical clearance procedures. Nearly 1,750 participants for overseas training should be processed this year. Realistic indicators for Institutional Excellence have been more difficult to establish, especially in terms of how to measure quality change or assign a quantitative figure to institutional reform. The project should begin in the summer of 1988 and further refinement of annual targets and goals will be made by the GOP/USAID contractor committee during the first year of implementation.

Lagging Areas/National Integration: The indicators established here are linked directly to USAID-financed activities in the lagging areas of Pakistan rather than any theoretical proxy measuring the extent to which "integration" is occurring. As the Mission has indicated on a number of occasions, we are under no illusions that any number of USAID-financed initiatives can "solve" the national integration problem in Pakistan.

Nevertheless, we are contributing to a long-term process through the provision of training and basic infrastructure. The innovative training program under BALAD involving fifty young Makranis is being expanded to cover the entire province of Baluchistan. One major infrastructure activity--the Kech River Bridge outside Turbat--is well underway. Road activities--in Baluchistan, the NWFP, and Sind--are in varying stages of design, contracting, or construction. One major road (the 110 kilometer Bela-Awaran road) is seriously behind schedule due to contractor mobilization problems, illustrating difficulties inherent in working in remote areas of Pakistan. The importance of the "lagging areas" initiative will almost certainly increase in the context of any "post Geneva" scenario for Afghanistan and Pakistan, and the upcoming Tribal Areas Development evaluation is designed to look specifically at these implications.

Narcotics: Overall poppy production levels in Pakistan will probably be at least as high as last year. Successful preventive enforcement in the Gadoon-Amazai area was more than offset by increased acreage elsewhere, primarily along the Afghan frontier but also in Hazara's Kohistan and the Black Mountain area adjacent to Gadoon. The number of heroin addicts in-country now exceeds 600,000 but may be leveling off. More details on USAID-supported narcotics activity are provided in a separate section of the Action Plan.

A final comment: One definite decision the Mission seeks from AID/W during Program Week this year is an indication on which of the CDSS indicators being tracked (and provided in Annex B) are acceptable more or less as is--and which ones are in need of further revision. The fact that the CDSS period roughly coincides with that covered by Pakistan's Seventh Five Year Plan offers a unique opportunity to track progress made in both documents over several years. Our view is that the indicators established so far do provide the basis for acceptable monitoring. We would welcome both AID/W suggestions during Program Week on how to improve these benchmarks and, if necessary, its direct assistance in the field.

IV. OTHER ISSUES

A. Private Sector

Private sector concerns are addressed through a combination of policy dialogue, project conditionality, training, sector support projects, and PL 480 self help measures. Significant achievements associated with USAID programming during the FY1982-FY1987 period include wheat derationing, edible oil deregulation, increase in private sector fertilizer distribution, regulations permitting private sector investment companies, introduction of private sector social marketing for contraceptives, establishment of private sector training programs, and acceptance of a private sector role in power generation.

Descriptions of private sector activities within the overall portfolio have been provided on a number of occasions, most recently in connection with the conference on trade and development in Indonesia in March. Specific areas of activity planned over the next twelve months include:

- Trade and Investment: As one outcome of the Indonesia conference, USAID plans to work with the Embassy to establish one or two FSN positions aimed at better promoting U.S. business opportunities within the context of the aid program. The fate of the $70 million private sector CIPs (PSCIP) in energy and agriculture will also be determined by the end of the fiscal year. Although the program languished for 24 months, recent interest has been more encouraging. Letters of Credit

(L/Cs) valued at approximately $10 million have been opened since the first of the year. Further L/Cs are anticipated in the coming weeks.

• Housing: Financing of Pakistan's huge housing requirements is a topic of growing importance. We have already conducted a housing finance study. Should our discussions with the GOP prove positive, we envisage a housing guarantee program initiated in late 1988. The program would likely be based upon the GOP instituting a number of policy reform measures over time to allow the formation of privately owned institutions mobilizing capital dedicated to use in the housing sector.

• Energy: The private power initiative stems from earlier studies sponsored under the Energy Planning and Development Project and should result in obligation of funds under a Private Sector Power Project developed in cooperation with the World Bank, Asian Development Bank, and other donors. USAID would likely provide funding for the institution-building aspects of the project and capitalization funds for an intermediate credit institution. In response to recommendations from AID/W last year, the Mission has taken further actions to promote oil and gas development in Pakistan with a special emphasis on maximizing the private sector's role. The USAID-sponsored National Oil and Gas Symposium in January 1988 was a milestone in this regard, and USAID continues to assist the GOP with preparation of its new national petroleum policy and oil and gas pricing policies. The Mission's energy conservation program provides direct assistance to qualified and competitively selected private industrial firms to cut energy costs. In the coal area, the Mission assists private coal lease holders with important data on coal resources and quality.

• Agriculture: The Agricultural Sector Support Program (ASSP) serves as the main Mission vehicle for addressing private sector concerns in agriculture, especially related to agribusiness. A major policy reform, after wheat derationing, is for the GOP to increase the gap between procurement and sales price to pay for storage and handling costs and to encourage private sector participation. A large private sector training program is ongoing, as are special studies, seminars, and workshops to promote private sector participation in extension services and seed production. Administrative rules and regulations which heretofore precluded private sector participation in seed production and marketing are being changed, and the private sector is expected to play an increasingly important role in this area.

• Health and Population: Activity already underway here as part of the Social Marketing of Contraceptives Project may be expanded to additional contraceptive commodities, depending on the outcome of the project evaluation originally scheduled for May but recently postponed due to the prevailing security situation in Pakistan. The Child Survival project is also based in part on NGO and private sector capabilities in the health field. The GOP is considering the establishment of a National Children's Commission which could make grants to various private sector activities as well as those undertaken by federal and provincial institutions (grants under SDF could also be used for NGO-related child survival activities).

• Training/Institutional Development: The innovative private sector training program initiated under the FY1982-FY1987 will be expanded in subsequent years. At least 500 private sector participants will be selected in FY1988, and a minimum of 20 percent will be women. For FY1989 the planned numbers are 600 and 22 percent respectively. The Institutional Excellence Project, also planned for this year if approved, will include programs aimed at assisting private sector higher education and research institutions such as the Lahore University for Management Sciences (LUMS), founded specifically by the local business community to meet future private sector needs in management and finance.

B. Non-Governmental Organizations

Although NGO development *per se* does not figure directly in the CDSS in terms of areas of concern, it is a cross-cutting issue that has come to the forefront in our policy dialogue with the GOP. In particular, it is central to our efforts to respond to NGO and WID needs in Pakistan and demonstrate the effectiveness of decentralized approaches to development that do not necessarily involve the government directly.

Bilateral funding for indigenous NGOs in the FY1982-FY1987 period was confined almost exclusively to $1 million in population-related areas through the NGO Coordinating Council (NGOCC). As a result of a year of policy discussions with the highest levels of the GOP, including the President and Prime Minister, we now believe we are on the verge of a major breakthrough that would result in the establishment of a fund ("The Center for Voluntary Organizations") outside the government dedicated to NGO/WID support. A $30 million cash transfer has been used to leverage this policy initiative.

As we have previously noted to AID/W, the policy turn around by the GOP is quite extraordinary. From a position of entrenched bureaucratic/ political opposition to the GOP ceding its predominate control of development funds or development activities, a true private sector foundation is now being recommended. The GOP's willingness to take a "hands-off" approach to this fund (and USAID willingness to take a similar approach) is commendable, as is the GOP's willingness to deposit more than Rs. 520 million to capitalize the Fund. We are ready to proceed on an SDF cash transfer grant. Once the Fund is formally established, we would look toward establishing a "helping" relationship in terms of technical assistance and training (both supported through Mission projects as well as centrally-funded programs), and coordinated multi-donor support.

Simultaneously to the ongoing discussions with the GOP on SDF, the Mission has sought GOP approval for AID direct grants to selected high-profile indigenous and U.S. NGOs. The GOP has responded positively to two proposals so far (Orangi Pilot Project and Edhi Foundation), and up to eight others may follow. The timing of the SDF agreement and implementation of the Fund concept will determine whether we must continue to utilize management intensive GOP approved AID direct grants. At a project level, support for NGOs is also contemplated under Child Survival and in a proposed add-on to the Forestry Planning and Development project. A special grant to the International Executive Service Corps (IESC) dedicated to agribusiness for trade and investment, as well as traditional IESC services, is being negotiated with the Ministry of Agriculture.

C. Human Rights

During the FY1982-FY1987 period, the Mission did not avail itself of central funds under the FAA 116(E) program. Human rights initiatives were small and largely focused on women in development, more specifically women's access to legal redress. In April of this year, the Mission submitted four proposals to AID/W for 116(E) funding as part of a larger Embassy/USAID human rights initiative. Two proposals support local initiatives in (1) publication of a Pakistan-specific human rights newsletter and (2) creation of an Islamabad office to serve as a legal aid center for women and a listening post the the National Assembly. A third proposal funds "second tier" Pakistani women interested in human rights for travel to the United States to observe the U.S. political process and activities of U.S. human rights activists and organizations. The fourth proposal, more traditional, finances Asia Foundation's arranging of U.S. observational travel for female legislators. In addition to these 116(E) initiatives, the Mission is developing a legal project focused on strengthening the rule of law in Pakistan, improving administration of justice and the access of the disenfranchised to the legal system.

D. PL 480 Title I:

The increase in PL 480 Title I funding from $50 million to $80 million annually should not have any impact on Usual Marketing Requirements (UMRs). The UMR for vegetable oil is based on prior commercial purchases by Pakistan. The increase in this year's program of vegetable oil under PL 480 (from $50 million in FY1987 to probably $80 million in FY1988) increases the total amount of soybean oil imports from the U.S. Imports from other countries are unlikely to decline because the growth in total imports will be sufficient to accommodate the larger PL 480 program without reducing total commercial imports. Thus the global UMR will be met without any difficult. Furthermore, the higher international price this year for vegetable oil means that the actual volume purchased under PL 480 may not be significantly larger than in previous years.

Corn imports of $10 million under this year's PL 480 Title I program had been planned to help offset last year's drought-reduced domestic crop. However, the government's trading parastatal can't find buyers so we expect the GOP to request more oil this year instead. The potential for future corn imports is unknown, although demand for poultry feed has been growing rapidly while domestic corn production is stagnant. There is a possibility for soybean meal imports under PL 480 or other U.S. credit programs. The GOP recently made changes in its import regulations to this effect, but implementation has yet to proceed. Pakistan also imports large quantities of pulses which could at some point be imported under the PL 480 program. However, the specific types of pulses in demand such as black gram and chick peas may not be available in sufficiently large quantities from the United States. Tobacco does not offer much potential; Pakistan only imports very small quantities of high quality tobacco for blending purposes. It exports both tobacco and tobacco products and is unlikely to accept the export limitations of a PL 480 program. We have discussed the possibility of other commodities with the GOP without coming close to an agreement. In our opinion, corn and soybean meal offer the most potential and we will continue to press for them under the PL 480 program if appropriate and not disruptive to development of private sector channels.

E. Wheat Procurement

The 1987 monsoon failed and was followed by poor winter rains. Therefore, the Mission, in response to a GOP request, committed itself to providing funding sufficient to procure as much as 1.5 million metric tons of wheat imports. A programming process now underway will make up to $170 million available for this purpose this fiscal year. Another $80 or $90 million would need to be made available next fiscal year to provide financing for the full 1.5 million tons. Recent crop estimates indicate that there is a possibility the original GOP request may be reduced to something more on the order of one million tons; time will tell. Although wheat financing should result in a healthy draw-down on the pipeline, it also introduces some programming difficulties at the very start of the FY1988-FY1993 program. Up-front funding needed for major infrastructure projects poses the greatest problem.

F. Narcotics

The narcotics issue is likely to become increasingly important over the next twelve months. GOP poppy eradication efforts in Gadoon during the past year (and the impact of drought in poppy growing areas) have not compensated for increased poppy cultivation in the Tribal Areas, Hazara (Kohistan and Black Mountain), and Dir. Overall opium production figures range from 130 to 170 metric tons in 1987-1988, compared to 140 to 160 metric tons in 1986-1987. Poppy cultivation in the Gadoon area, where USAID is directly involved on the development side, has almost been eliminated (estimated planted acreage in 1986-1987 was more than 9,000, compared to on the order of 500 to 1,500 this year), the main bright spot in the current picture. Expansion of project activities to the adjacent Kala Dhaka area will begin shortly.

As poppy acreage increases in Hazara, and in areas along the Afghan border (Dir and the Tribal Areas), it becomes more difficult to control. Implementation of the UNFDAC (and USAID-supported) crop substitution effort in Dir continues to be difficult. Recent changes in the handling of the poppy cultivation clause under the Tribal Areas Development Project offer some immediate flexibility, but the long-term outlook for the heavily armed Tribal Areas (where GOP access is on occasion difficult if not impossible) is unpredictable. Cultivation in Bajaur and Mohmand Tribal Agencies in particular has seen considerable increases over recent years. Here again, events in Afghanistan could have significant impact on our programming in Pakistan and may make enforcement more difficult.

On the demand side, the number of heroin addicts in Pakistan exceeds 600,000. Their demand not only helps drive local production but makes Pakistan a net importer of opium. UNFDAC recently reported that, based on preliminary information, the rate of heroin addiction appears to be leveling off. Also, USIS conducted a poll to determine the effectiveness of recent narcotics awareness campaigns supported by USAID and other donors. The poll revealed that the Pakistani general public now believes the country has a major drug problem.

USIS, NAU and UNFDAC are attempting to convince the Pakistan Narcotics Control Board (PNCB) to revise its strategy for the awareness campaigns to instruct the public on how they may resolve this problem rather than just making them aware of it. A Drug Abuse Prevention Resource Center is being established. A long-term expatriate advisor has been hired using EEC funds. A PIL earmarking $65,000 for other costs and commodities under the Regional Narcotics Education Project (398-0355) will be issued shortly and the amendment to the Northwest Frontier Area Development Project providing the rest of the funding for establishing the center should be approved in May.

G. Management Issues

The Mission accepts that all design and implementation work must be done within the current limits of 43 USDH staff members. Nevertheless, the workload continues to grow as the program matures and as new projects for the Post 1987 period are added. FSN staff necessarily play an increasingly important role in managing this burden, and in numerous instances FSNs have project management responsibilities that normally are carried by USDHs.

AID/W has expressed concerns over the management implications of infrastructure projects. Management intensity tends to be highest in small-scale development activities such as those supported under BALAD, TADP, and NWFADP. For the latter two, a large engineering staff stationed in Peshawar plays a central role. Management intensity is expected to be proportionately less in such projects as Guddu, Bolan Dam, Lakhra and Lowari, if the Mission decides to proceed with one or more of these activities. This is because these will be in effect "turn key" type activities managed largely by A/E contractors.

In other instances, AID/W concerns over project structure or the very nature of some of the activities in which we are involved do translate into increased management intensity. Institutional Excellence as currently designed, for example, is more complicated and more management intensive than originally envisaged. Child Survival also looks to be more complicated and management intensive than it might have been, due in part to the complexities inherent in the health sector. The Mission is working to capacity with a finite number of USDH. Therefore, as we take up new initiatives, we will have to necessarily choose carefully what can be effectively managed. On occasion, selection of a new program will mean dropping other activities of relatively lesser importance already underway.

ANNEX A:

SUMMARY OF DOCUMENTS PENDING FROM LAST YEAR

Document	Current Status
1. Amplification of Agricultural Sector Strategy	Submitted and reviewed in AID/W in September/October 1987; AID/W response provided in 87 State 343114. Mission to review Agricultural Commission Report released in April 1988 and provide any modifications in strategy as required.
2. National Integration Strategy	Submitted to AID/W by cable in October 1987 (Islamabad 21618). Follow-up cable from AID/W (State 36981) received and responded to in February 1988 (Islamabad 3025).
3. Cash Transfer Paper	Submitted to AID/W by cable in February 1988 (Islamabad 3028).
4. CDSS Benchmarks	Submitted to AID/W in January 1988. Progress report and a small number of modifications provided in Annex B of this Action Plan.
5. Domestic Resource Mobilization Paper	Submitted to AID/W in April 1988.
6. Energy Sector Strategy	Submitted to AID/W in May 1988 with Action Plan; revised strategy planned for FY1989.

ANNEX B:

CDSS INDICATORS MATRIX

Indicator	Current Status
1. Balance of Payments Pressure	
- Foreign exchange reserves averaging two months of imports by 1993.	Foreign exchange reserves now average 4 weeks of imports.
- Trade balance narrowing each year.	Trade deficit declined from its base of \$3,042 million in 1985-1986 to \$2,284 million in 1986-1987.
- Export growth averaging 8 percent per year by 1993.	Exports increased from \$2,942 million in base year 1985-1986 to \$3,498 million in 1986-1987, an increase of 19 percent.
2. Inadequate Domestic Resource Mobilization	
- Budget deficits averaging not more than 4.5 percent of GDP by 1993.	Budget deficit in PFY87/88 was 8.6% of GDP. The 1988/89 figure is expected to be 6.3 percent of GDP.
- Major tax reforms introduced.	Some reforms possible as part of budget announcements anticipated in June 1988 in connection with the Seventh Five Year Plan.
- Inauguration of private investment institutions	Three have been selected and likely will be in operation in the next year.
- Movement of autonomous public sector institutions off the government budget.	GOP has announced intention of moving T&T off-budget in PFY 1988-1989. WAPDA has floated government-guaranteed bond issues.
- Water user charges covering 100 percent of the operations/ maintenance of the irrigation system by 1993	(See Section on Agriculture)
- 50 percent decrease in agricultural subsidies by 1993.	(See Section on Agriculture)

3. Low Agricultural Productivity

- 50 percent increase in maize production by 1993.	Maize production increased from 1.009 million metric tons, in base year 1985-1986 to 1.111 million metric tons in 1986-1987. Because of drought conditions, the 1987-1988 figure is estimated at only 0.85 million metric tons.
- 50 percent increase in marketed dairy production by 1993.	Marketed dairy production increased from 11,508 million metric tons in base year 1985-1986 to 12,198 metric tons in 1986-1987, an annual growth rate of 3.03 percent.
- 50 percent reduction in the percentage difference between the current average world and Pakistani yields for wheat, rice, cotton and sugarcane by 1993.	Too early to establish long-term trends here. The most recent wheat crop was unusually poor, cotton yields unusually high. Current status (actual gap, 1985-1986; actual gap, 1986-1987; target gap, 1993) is as follows: wheat (19.6%; 32.0%; 9.8%); rice (52.1%; 48.3%; 26.0%); cotton (63.2%; 61.7%; 31.6%); and sugarcane (39.0%; 33.2%; 19.5%).
- 50 percent decrease in agricultural subsidies by 1993.	Prices for DAP and SOP fertilizer were increased by 10 and 25 percent respectively from 1985-1986 to 1986-1987. Estimated fertilizer subsidy has declined from Rs. 2,408 million in 1985-1986 to Rs. 1,860 million in 1986-1987.
- Water user charges covering 100 percent of the operations/maintenance of the irrigation system by 1993.	Despite a 5 percent annual increase in water user charge revenues over the past five years, revenues as a percentage of O&M allocations have declined from 53 percent in FY1983 to 38 percent in FY1987 (this is due to the even larger increases in funding for O&M, another policy goal). With the potential decrease in O&M costs resulting

from the privatization of public tubewells and increased revenues resulting from the adoption of improved water user charges assessment and collection practices, the revenues are expected to cover 100 percent of the costs of the irrigation system by 1993 (the Punjab already recovers almost 100 percent of its O&M costs if public tubewells are excluded from its O&M expenditures).

- Measureable progress in institutional reform and development, including increased expenditures for operational costs relative to salaries, revised personnel procedures in which promotion is based primarily on merit, and improved definition of goals and priorities.

Institutional reform has regressed with respect to increases in operating costs relative to salaries. Civil servants received pay raises last year, but operating costs for recurrent and development projects were not maintained at even the previous year's level. There has been progress in other areas. Research personnel under the TIPAN project in the NWFP are being promoted on the basis of merit rather than seniority, and are allowed to continue as researchers. A revised "university policy and goal statements" has been drafted. A 12-year research program for the National Agricultural Research Center (NARC) in Islamabad has been prepared. A management review has also been completed and recommendations acceptions.

4. Energy Deficit

- WAPDA establishment of a revised tariff system which introduces peak load pricing for large industrial consumers.

WAPDA has an internal tariff study underway and tariff revisions are anticipated in FY1988, possibly including peak load pricing as proposed in the draft Seventh Five Year Plan.

- Pakistan will increase power generation capacity by 1500 MW by 1993.

Total capacity now stands at 6,516 MW. An increase of 200 MW is expected this year.

- Creation and staffing of a potentially separable distribution wing within WAPDA by 1989.	The Distribution Wing was formally established in 1987 and staffing of key new management positions was completed in December 1987.
- GOP approval of a Rural Electrification Master Plan which features socio-economic criteria for village selection.	Terms of reference for development of a Master Plan based on socio-economic criteria for village selection have been approved by WAPDA and a contract has been let to complete a draft plan by June 1988.
- Energy conservation program will result in annual savings of 1.63 million tons of oil equivalent, by 1993.	For FY1987-1988, the Pakistan national energy conservation program achieved a savings of 120,000 tons of oil equivalent.
- Power transmission and distribution losses will be reduced from the current level of 26 percent to 22 percent or less by 1993.	Work is now underway on the Energy Loss Reduction Program and substantial loss reductions have been realized in individual localities. Actual distribution system losses recently were estimated at approximately 24 percent.
- At least one precedent setting Private Sector Power Project will be on line by 1993.	Negotiations on letters of intent are in progress with three project sponsors. One letter of intent for 130 MW has been signed and the ECC has authorized another to be signed for 1,300 MW. USAID and the World Bank are designing projects to assist private sector firms in this area.
- Double farm fuel production by cooperating farmers with a 50% increase in total fuelwood production.	Planting of new acreage of fuelwood trees in 1986-1987 totalled 4,000 acres.
- GOP approval by 1993 of hydroelectric power project(s) which will generate an additional 1000 MW of power.	High level GOP and provincial political discussions on Kalabagh Dam continue. The draft Seventh Five Year Plan contains plans for advance preparation for two other major hydro projects.

5. High Population Growth Rate

- Acceptable voluntary family planning methods accessible to an estimated 60 percent of couples by 1993.	No survey now exists to measure accessibility in terms of time and range of contraceptives available. Informal and unofficial estimates suggest that between 15 and 30 percent of the population have easy access to family planning services. If an appropriate monitoring mechanism is not agreed upon for this indicator, it will be dropped from the list.
- Approximately 15 percent of users of reversible methods supplied by private sector sources.	Private sector supplied between 4 and 5 percent of users of reversible methods during the July 1986-June 1987 period, the most recent full program year.
- Total fertility rate lowered from 5.7 to 5.2 live children per woman by 1993.	A demographic survey planned for 1989 includes this indicator. The 1984-1985 Contraceptive (prevalency Survey found the total fertility rate to be 5.95 among interviewed women).
- Contraceptive use prevalence increased from 10 percent to 20 percent of couples "at risk".	According to the 1984-1985 Contraceptive Prevelancy Survey, current users were estimated at 9.1 percent, with 7.6 percent using modern methods. A near-final draft of the Seventh Five Year Plan estimates the level in 1987-1988 at nearly 13 percent.

6. High Rates of Infant and Child Mortality

- Reduce 1987 estimated infant and under five mortality 25% by 1993 to respectively 78/1000 live births and 120/1000 live births.	March 1988 WHO-organized survey showed 81 percent of one to two year olds fully immunized; ORS use in over half of all diarrhea cases, and doubling of tetanus toxoid coverage of women since 1986 to 40 percent. Impact on infant mortality, although unmeasured, is likely significant.

- Reduce annual level of malaria incidence from 1,400 cases to 500 cases per million population by 1993.	Malaria incidence declined from 1,400 cases per million in 1986 to 970 in 1987, a one-third decline due largely to the 1987 drought and low mosquito density.

7. Low Primary School Enrollment Rates

- Revised primary school curriculum.	Not applicable at this point, to be developed and amplified in context of Primary Education PP
- Number and distribution of revised teaching/learning materials and development of textbooks and teaching guides.	Same as above
- Number of primary teachers and supervisors trained to implement revised program(s).	Same as above
- Number of primary schools constructed for boys and girls.	Same as above
- Number of middle schools for girls and female teachers training facilities expanded.	Same as above
- School census/management information system instituted.	Same as above
- Provincial Ministry of Educations establish Primary Education Directorate.	Same as above

8. Quality Improvement in key Institutions

- Some 7000 people from a wide range of public and private institutions receive overseas training in management and technical fields, and return to Pakistan.	About 1,740 participants are projected to be sent overseas in 1988. Subsequent years should see a 15 percent increase.

- At least 20 institutions, identified as outstanding sources of higher education, training and research, strengthen and improve their high standards and serve as a demonstration for existing public colleges and universities and potential new private institutions.	The Institutional Excellence Project (IEP) aimed at achieving this goal should begin in 1988. At least four institutions will begin to receive support soon after, including at least one from the private sector.
- Advanced degree training for 120 as part of program to help upgrade faculty and staff in key higher education institutions in areas reflecting national development priorities.	Priority training needs, and nominating and selection criteria to be developed under IEP; 25 long-term participants anticipated during the first year.
- Joint research/linkages to address national development issues established between 10 Pakistani universities, research laboratories and private sector, as well as linkages between Pakistani institutions and a minimum of eight U.S. institutions.	IEP seeks to increase allocation for university level research from current 2 percent of university operating funds and to encourage funding from the private sector; four such linkages are anticipated the first year.
- Increase in GOP expenditures on education.	GOP investment in education now represents 2.5 percent of GDP; IEP and a proposed primary education project seeks to support increases in this level to at least 3 percent in 1989/1990.

9. Lagging Areas

- Overcome isolation by improving/expanding surface transportation network in rural Sind, southern Baluchistan, and NWFP (reconstruction of 400 kms paved road, 250 kms new shingle roads, and 2000 kms new katcha roads).	In Southern Baluchistan the A&E work is completed and contract signed for the 110 km Bela-Awaran Road; contractor is in the process of mobilization. A/E contract for the design of the 255 km Awaran-Turbat road is in its preliminary stages and is expected to be signed in May 1988. Approximately 12 percent of the construction of the Kech River Bridge is completed, along with 7 percent of the approach road. Fiftyfive kms of road

construction started under the FY1982-FY1987 program in the NWFP is complete and another 50 kms is under construction. Construction under the Roads Resources Management Project in Sind is not expected to begin until 1989.

- Access to social services, electricity in lagging areas improved and expanded.	Six villages in Gadoon-Amazai area of NWFP electrified during previous period; work on electrifying fourteen more in progress. Another 80 villages are expected to be planned under Gadoon II. Thirteen primary schools have been constructed in the Tribal Areas, 23 in southern Baluchistan.
- Agricultural, mineral and other resources that might provide employment and incomes in economically depressed areas identified and developed.	Bolan Dam Project expected to begin this year. Dozens of small-scale infrastructure activities underway or completed, especially in Gadoon. Project there is also funding infrastructure for 170 acre industrial estate which will provide short-term employment during construction and long-term employment after industries are set up. Finally, an ongoing employment generating agriculture extension program under implementation through December 1988 will provide short-term employment for up to 2,000 persons. Under TADP, 12 irrigation sub-projects are underway or complete.

10. Narcotics

- Elimination of 50% of 1986-1987 poppy production levels in provincial tribal areas and to the extent possible in federal tribal areas by 1993.	The 1987-1988 poppy crop in Pakistan is estimated at 130-170 metric tons, compared to 140-160 metric tons in 1986-1987.
- Institutionalization of the national drug awareness program.	USAID/Islamabad helped fund three national narcotics awareness campaigns on an ad hoc basis during the

FY1986-FY1988 period. Future campaigns will be funded through a Drug Awareness Center (being established within the PNCB), which should offer expanded support for awareness-related activities throughout Pakistan. The total number of heroin addicts in Pakistan is estimated at more than 600,000.

- Implementation by UNFDAC and other donors of additional poppy substitution area development projects under the Special Development and Enforcement Plan.

Under the Special Development Enforcement Plan (SDEP), the Special Development Unit for Poppy Growing Areas has been functioning with a full-time Director for more than a year. The Dir Area Development Project was started in June 1985. Currently over 220 projects are under implementation, including potable water supply, irrigation channels, and path improvements. The project is operational but is suffering from staffing problems. The Embassy and INM are seeking to start development projects in Bajaur and Mohman using State funding.

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THE USAID DOMESTIC RESOURCE MOBILIZATION PROGRAM

A. Introduction

The FY88-93 CDSS identified Domestic Resource Mobilization (DRM) as one of the 10 development problems that USAID would address. The USAID objective is to improve public sector revenues and mobilize greater financial resources for private sector investment. The low level of public revenues, and the associated budget deficit, help to explain many economic and social problems in Pakistan such as poor support for primary education and public health, the deteriorating physical infrastructure and a general shortage of most public goods. The low level of domestic savings threatens long term growth prospects because total savings are inadequate to finance private sector investment, maintain productive capital investment, and provide the physical and social infrastructure necessary for a rapidly growing population. A continued low level of DRM is a serious threat to sustained economic growth, price stability and improvement of social services. After the summary, this paper reviews major problems, government revenues and expenditures, private sector resource mobilization, identifies constraints to expanding DRM and presents the USAID strategy and program.

B. Summary

1. Problems: The two basic problems associated with DRM are the poor job that the Government does in providing public services and inadequate savings for long run, sustained growth. Public services are deficient both in quantity and quality. The savings that occur often are short term and not readily transformed into long term investment. In fact, private savings are used to finance public consumption. Public services like education, roads, etc. and larger, private sector investments are essential for economic and employment growth, which in turn are necessary requirements for stability, the goal of the U.S. economic assistance program.

The Government, at the federal, provincial and local levels, has been unable to increase the supply of public services in line with population growth and also close the gaps in education, health, sanitation and electricity services. The 3.1 percent annual rate of population growth will result in the population increasing from approximately 100 million in 1987 to 120 million in 1993, the last year of the CDSS and 7th Five-year Plan. Continuation of this growth rate will produce a population of approximately 150 million in the year 2000, which is only 12 years away. This 50 million increment is an enormous number of people to feed, educate and employ.

The labor force is growing faster than the population. The labor force participation rate is grossly underestimated because most women are not included even though many rural women engage in farm activities. There is an increasing tendency for women to work in paid employment when they move off the farm. Thus the work force could be growing at a 4 to 5 percent annual rate rather than the 3.4 percent listed in official statistics, which would nearly double it by the year 2000 with consequent social problems if employment does not keep pace.

The rapid population growth creates an enormous burden on the government to provide education to the rapidly growing school age population. The greatest domestic pressure has been to increase enrollments at the college and the secondary level, which is much more expensive on a per pupil basis than primary education. The greatest need, however, is at the primary level (40-50 percent of that age group attend school), which until recently has been starved for funds. The government has tried several innovative methods to increase enrollments at the primary level, but success in both quantitative and qualitative terms is unknown. Because of inadequate revenues and rapid population growth, the absolute number of illiterates is increasing.

The population growth rate is unlikely to decline over the next 5-10 years regardless of changes in the birth rate. One reason is the success of the Expanded Program of Immunization and Oral Rehydration Therapy, which are lowering the still high infant mortality rate. These cost-effective measures are keeping many children alive who otherwise would die. This reduction in infant mortality is a necessary condition for a subsequent reduction in the birth rate and ultimately the population growth rate. The lack of government revenues, however, is impinging on the ability to deliver other types of health services and basic education, which also would contribute to a reduction in the birth rate.

The quality of various public services has been declining, largely as a result of efforts to meet the large demand with limited revenues. For example, due to inadequate funds for proper supervision, classroom attendance by teachers is very poor, which results in poor performance by students. This poor performance cumulates through the entire education process so the quality of university graduates is substantially lower than it was 15 or 20 years ago. The quality of health services in both city hospitals and rural health centers also has declined because funds are inadequate to supply drugs and pay salaries adequate to keep people on the job. Inadequate maintenance and falling construction standards have resulted in a deterioration of the transportation and irrigation systems. The capacity to supply reliable electricity and gas service has fallen behind demand. Without adequate human and physical infrastructure, long run self-sustained growth is not possible. Inadequate domestic resource mobilization (DRM) is at the heart of these problems.

2. Symptoms: An examination of government budgets quickly points out the symptoms of inadequate DRM. The most obvious indicator is the growing budget deficit, i.e. the difference between total expenditures and total tax and non-tax revenues. For example, the deficit grew at an annual rate of 45 percent between 1980 and 1987 while total revenues were growing at a rate of 17 percent, slightly lower than the nominal GDP growth rate (see Table 1). The budget deficit was 8.9 percent of gross domestic product (GDP) in 1986/87, up from 5.3 percent in 1980/81. The major method of financing this deficit has been borrowing from the non-bank sector, which increased at an annual average rate of 97 percent during the 6-year period. This financing is very expensive in terms of annual interest charges and is unlikely to yield much in the way of net additional revenues in the near future. In 1986/76, interest costs on

Table 1

Revenues, Expenditures, Deficits and Financing

	1980/81 (Billion Rupees)	1986/87 (Billion Rupees)	Annual Growth Rate (%)	Percentage of GDP 80/81	Percentage of GDP 86/87
Total Revenues	49.0	100.0	17.3	16.9	17.1
Tax Revenues	38.8	78.1	16.8	14.0	13.0
Expenditures	63.3	156.4	24.5	22.9	26.1
Current	40.3	113.5	30.2	14.5	18.9
Development	23.3	42.9	14.0	8.4	7.1
Deficit	14.6	53.7	44.6	5.3	8.9
External Financing	7.7	11.3	7.7	2.8	1.9
Non-Bank Financing	4.5	30.6	96.6	1.6	5.1
Bank Financing	2.4	11.8	65.2	0.8	2.0
Total Internal Debt	62.5	243.4	48.2	22.5	40.3
Internal Debt Service	3.6	15.3	54.1	1.3	2.5
Average Interest Rate	6.0%	13.5%	20.8	-	-
Taxes as Share of Expenditures	61.3%	50.0%	(3.0)	-	-
Gross Domestic Product	278.0	602.1	19.4	-	-

the domestic debt were Rs.15 billion while the amount raised was Rs.30.6 billion. Another problem is that government borrowing may crowd out the private sector or raise the cost of capital for the private sector. Without a significant increase in the rate of revenue growth, the government will be forced to further finance the deficit from the banking system, with a probable increase in the rate of inflation.

Another symptom of inadequate revenues has been the growing share of current expenditures compared with development expenditures. During this 6-year period, current expenditures grew at an annual average rate of 30 percent, whereas development expenditures grew by only 14 percent. Current expenditures went from 64 percent of total expenditures to 73 percent while development expenditures declined from 36 to 27 percent. Current expenditures reflect the rapid growth in public employment and salaries. The quantity and quality of public services on a per capita basis, however, are declining because of slow growth in the development budget despite the growth in employment. The other large items in the current budget are defense expenditures and interest payments. Interest on the domestic debt is the most rapidly growing item in the budget and results from the budget deficit. Defense expenditures, although very large, are declining slightly as a percentage of total government expenditures. While there are opportunities for expenditure reductions, they must be accompanied by revenue enhancement measures to reduce the deficit significantly.

3. Programs: USAID has been concerned about the problems of poor maintenance of the physical infrastructure, inadequate investment, government subsidies and parastatal costs since our bilateral development program resumed in 1982. The CDSS has broadened these concerns and set sub-objectives and targets to address these items, e.g.:

- Budget deficits averaging not more than 4.5 percent of GDP by 1993;
- Major tax reforms introduced;
- Inauguration of private investment institutions;
- Movement of autonomous public sector institutions off the government budget.

The policy dialogue, conditions precedent and analytical studies in projects and programs have begun to address some of these issues. DRM issues have been at the forefront of the annual economic policy reviews with the Government of Pakistan since its inception in 1986. Reductions in subsidies and privatization of public enterprises can help to alleviate the DRM problem by shifting costs from the public to the private sector, with a consequent increase in efficiency. For example, the share of the private sector in fertilizer distribution grew from 30 to 60 percent during this period, thus reducing distribution costs in the budget. The ration system for wheat has been eliminated, cutting the subsidy bill for wheat by about one-third. Increased electricity rates generated large revenues for the parastatal, thus lowering its demand for budget allocations.

During the CDSS period, USAID will continue its efforts to: 1) reduce subsidies; 2) increase user charges; 3) enhance tax recovery; and 4) improve the financial sector. We will try to shift investment and production activities from the public to the private sectors, or at least off the budget. We will expand our efforts to persuade the government to reduce expenditures, which may be easier to accomplish than raising taxes. We also will be supporting revenue research and programs of the multilateral banks to raise tax revenues. Finally, we will continue our efforts to promote private sector investment companies and housing finance institutions as ways of mobilizing resources.

The World Bank has been the lead institution in carrying out a policy dialogue with government on DRM. It is now concentrating on tax revenues while continuing its efforts to increase user charges. USAID has supported, and will continue to support all such efforts by the World Bank. Both the World Bank and the Asian Development Bank have been carrying out studies on the financial sector, but these have not yet been published in final form or resulted in policy change. USAID has been following these activities very closely and will be ready to seize the opportunity to pursue particular items where we have a comparative advantage.

C. Government Revenues, Expenditures and the Deficit

Major emphasis in Pakistan has focussed on the budget deficit and public revenues rather than on expenditures. The reason is that government expenditures, with some notable exceptions, have been seen as not unreasonable (one-fourth of GDP), although there is growing discontent with the government services provided. While there is scope for a reduction in subsidies and restraint on administrative expenditures, major categories such as defense and debt servicing are essentially uncontrollable. In fact, these two categories plus grants for education and grants to the provinces account for more than 82 percent of current expenditures (see Table 3). Thus, the major solution to the necessary reduction in the budget deficit must be growth in revenues, particularly taxes.

Revenue performance over the last eight years has been very poor in relation to the growth of the economy. Total revenues have risen almost as fast as GDP (see Tables 1 and 2) but expenditures (see Table 3) have risen much faster. Direct taxes, primarily personal and corporate levies on income, have been the worst performing of all categories, rising at only half the rate as the economy. In 1980 the income tax was equal to about 22 percent of indirect taxes, but by 1987 it had fallen to about 16 percent. This is the category that is expected to increase most rapidly as an economy grows and develops. The major reason is a failure to assess and collect taxes that are due. Some small part of the shortfall may be due to black (illegal) money, but most of this money is not included in GDP. Rates have been lowered in an effort to make payment of taxes more attractive than tax evasion, which creates more black money, but the results to date have been disappointing. One reason is a regulation that prevents audits so long as the annual increase is at least 20 percent. Starting from extremely low and artificial bases, many tax payers will never (in their lifetime) pay anywhere near the normal, legal rate. The current estimate is that about one-fourth of the individuals who have sufficiently high incomes to pay income tax actually pay any income tax. About 40 percent of remittances and 30 percent of economic output lie outside the recorded economy and thus outside the tax net.

Table 2
Consolidated Tax Revenues, Growth Rates, Share of GDP and Buoyancy

	Revenues		Annual Growth Rate	Revenues as a % of GDP		Buoyancy-with respect to GDP a/
	1980/81	1986/87		1980/81	1986/87	
	(Billion Rupees)		%	%	%	
Income Tax	7.0	11.1	9.7	2.5	1.9	0.5
Major Indirect Taxes	31.1	69.1	12.7	11.2	11.6	0.7
Import Duties	13.6	24.6	13.4	4.9	4.1	0.7
Excise Duties	10.5	16.8	10.0	3.8	2.8	0.5
Sales Tax	2.9	5.5	14.9	1.0	0.9	0.8
Surcharges	1.7	14.9	129.4	0.6	2.5	6.8
Petroleum	0.9	11.1	188.8	0.3	1.9	10.0
Export Taxes	0.7	0.9	4.7	0.3	0.2	0.2
Other	1.9	2.4	4.3	0.7	0.4	0.2
Total Taxes	38.8	81.8	18.4	14.0	13.8	1.0
Non-Tax Revenues	8.1	21.8	28.1	2.9	3.7	1.5
Total	47.0	103.7	20.1	16.9	17.5	1.1
Autonomous bodies	2.0	3.7	14.1	0.7	0.6	0.8
Grand Total	49.0	107.4	19.8	17.6	18.1	1.1
Provincial Taxes and Non-Tax Revenues	2.9	5.2	13.2	1.0	0.9	0.7
Gross Domestic Product	278.0	592.5	18.5	-	-	-

a/ Calculated by dividing the annual growth rate of the tax by the annual growth rate of GDP.

Sources: World Bank, Pakistan: Sixth Plan Progress and Future Prospects, Feb 26, 1987, Tables, 5.01, 5.03, 5.04.

The major source of government revenues is taxation of foreign trade. Import duties now are 30 percent of tax revenues, but excise taxes, sales taxes and surcharges, which mainly result from imported materials, amount to nearly 45 percent of tax revenues. The imposition of surcharges on import duties in the last few years, the markup on petroleum imports since 1986 and increased revenues resulting from imported edible oil price declines are the major sources of revenue growth. The surcharges on imports for some items are larger than the normal duties and have raised the rate of protection at a time when Pakistan is trying to lower duties in order to make industry better able to compete on the export market. This added protection is an undesirable byproduct of the need for additional resources.

Provincial and local government revenues have been declining as a percentage both of GDP and total revenues (see Table 2). One major reason is the readiness of the federal government to provide non-obligatory grants to the provinces to cover their deficits. Another reason is the institution of Ushr, which reduced land revenues and is ostensibly used for charitable activities (see Table 3). As a result, provincial and local government revenues were reduced, leading to a fall in the local/provincial share of total government revenues from about 6 percent in 1980/81 to about 5 percent in 1986/87. Another reason has been the slow growth in collections for irrigation water compared with the growth in expenditures for canals and tubewells. Provincial revenues now finance about 20 percent of current expenditures, down from 70 percent fifteen years ago.

In recent years much of the growth in revenues has come from surcharges that produce a large amount in the first year but then grow at a rate equal to or less than the economy. Revenue growth from imports at a time when total imports have declined demonstrate the short-term nature of this source of revenues.

While revenues have been growing at a slightly lower rate than GDP, expenditures, particularly current expenditures, have been growing much more rapidly (see Tables 1 and 3). In 1986/87, current expenditures rose by 17.8 percent while revenues went up by 10.8 percent. Taxes as a

TABLE 3

GOP BUDGET EXPENDITURES
in billions of rupees

ITEM	1980-81	1987-88	Annual Growth Rate (%)	As % of Budget 1980-81	As % of Budget 1987-88
CURRENT					
Defense	14.08	44.25	15.00	24.36	25.29
Gen Admin	1.68	5.25	14.88	2.91	3.00
Alloc. Prov.					
Normal	0.48	2.09	23.48	0.83	1.19
Non-obligatory	0.62	11.52	123.06	1.07	6.58
Debt Service					
Domestic	2.52	18.43	44.19	4.36	10.53
Foreign	5.49	17.42	15.21	9.50	9.96
Subsidies	2.58	5.67	8.38	4.46	3.24
Econ/Social Ser	2.94	7.71	11.36	5.09	4.41
Other	0.96	2.92	14.29	1.66	1.67
Total	31.35	115.26	18.74	54.23	65.88
DEVELOPMENT					
Departments	8.12	13.04	4.24	14.05	7.45
Auton. Bodies	9.80	20.10	7.36	16.95	11.49
Fertilizer Sub.	2.42	1.67	-2.17	4.19	0.95
MNA Program	0.00	2.50	0.00	0.00	1.43
Spec. Dev. Prov	0.00	1.19	0.00	0.00	1.68
Prov. Dev.	4.89	14.50	13.76	8.46	8.29
Other	1.23	0.00	-7.00	2.13	0.00
Total	26.46	53.00	7.02	45.77	30.29
DEV GRANT PROV FOR ED	0.00	6.70	0.00	0.00	3.83
GRAND TOTAL	57.81	174.95	14.18	100.00	100.00

percentage of expenditures declined from 61 percent in 1980/81 to 50 percent in 1986/87. Non-tax or other extraordinary revenues in the last few years have taken up some of the slack. The decline in imported petroleum and edible oil prices boosted revenues by about 10 billion rupees annually in the 1985-87 period because of trading profits by public agencies and adjustible duties. The high price for cotton and cotton yarn exports will generate large revenues (Rs. 5-10 billion) in 1987/88 because the government taxes the producer surplus through its monopoly on exports of cotton and a duty on yarn exports. None of these revenues is likely to last more than a few years because current prices are deviating from longer run projections.

The situation of stagnant growth in real revenues is exacerbated by the rapid growth in current expenditures, primarily those of debt servicing and defense. Although defense expenditures have not increased as a percentage of GDP, they have not gone down either. Furthermore, some defense expenditures probably are hidden, particularly imports of weapons on credit. The amount of funds being transferred to the provinces also has risen rapidly, leaving little extra for the federal government and reducing the incentive for provinces to raise their own funds or control their expenditures.

The budget deficit has been increasing as a result of the above trends (Table 1). The deficit in 1986/87 was 34 percent of total expenditures, compared with 23 percent in 1980/81. The deficit as a percentage of GDP rose from 5.3 percent in 1980/81 to 8.9 percent in 1986/87. The 1987/88 projection is 7.8 percent, but the actual figure may be higher.

The GOP finances the budget deficit by external borrowing (foreign aid), borrowing from the private sector and borrowing from the banking system (monetary expansion). Table 1 contains data for two different years. Banking system financing is considered to be the most significant because of the inflationary impact. This percentage rose from 0.8 percent of GDP in 1980/81 to 2.0 percent in 1986/87. Non-bank borrowing is equally important, however, because it creates a domestic debt on which interest must be paid and reduces the funds available to the private sector for investment. Government domestic debt has been growing at a 45 percent average annual rate over the past six years, and interest payments by 54 percent. Domestic interest charges have risen from 8 percent to 16 percent of current expenditures (see Table 3) and are the largest item after defense. Total interest payments, both foreign and domestic, are projected to rise from 20 percent of current expenditures in 1986/87 to 30 percent in 1994/95. As a share of GDP, they would rise from 3.8 percent to 6.3 percent. Total debt service is estimated to be 20.5 percent of total expenditures in 1987/88 or 31 percent of current expenditures.

Non-bank borrowing reduces the amount of amount of money available to the private sector and raises its cost. The government increased its borrowing from Rs. 4.5 billion in 1980/81 to Rs 29.6 billion in 1986/87, mainly by paying interest rates in the 12-16 percent range. These rates are higher than what most firms pay for credit from the banks (average rate for working capital is 13 1/2 percent). This borrowing has risen from about one-quarter of private savings in 1980/81 to 45 percent in 1985/86 and could go as high as 58 percent in 1994/95.

The World Bank has taken and continues to take the lead among donors in urging action on the DRM problems. The World Bank President sent a letter to the Prime Minister of Pakistan in August 1987 suggesting a substantial cut in the lending program if Pakistan did not take measures to reduce its budget deficit. The growing deficit is one manifestation of the GOP's inability to increase revenues in line with modest increases in expenditures. The ADB and the IMF also are concerned about the budget deficit. The IMF has not provided any new funds in the last five years, primarily because the GOP would not agree to the attached conditions. The World Bank has clarified its August position and defined minimum targets that Pakistan should meet by July 1988.

USAID concern with DMR has manifested itself in the past six years through efforts to reduce subsidies in certain sectors such as agriculture (fertilizer, wheat, irrigation) and to raise revenues through higher user charges for electricity and irrigation water. During the current six-year program, the Mission will continue to push a broad based program to increase domestic resource mobilization both in terms of government revenues and also in the private sector.

D. Private Sector Resource Mobilization

The government deficit and non-bank borrowing to cover it are especially worrisome because of the low savings rate (see Table 4). The domestic savings rate is estimated to have risen from 6.2 percent of GDP in 1980/81 to 9.1 percent in 1986/87, after a decline to 4.8 percent of GDP in 1984/85. The accuracy of savings figures is rather low so the trend may not be conclusive. These figures do not include the activities of the large, informal capital market, so the rising trend may represent a shift into the recorded economy but not a change for the total economy.

Savings can be defined either as national savings or as domestic savings. National savings includes foreign assistance and remittances. It is clear from studies that only a small part of remittances are invested, even if the purchase of land for the construction of housing is defined as savings. Although domestic savings apparently now are on an upward trend, they still are low compared to other developing countries such as India, where the figure is 20 percent of GDP or more. The fact that public sector savings have ceased reduces the impact of improvements in private savings.

Although the share of the private sector in savings has increased, data on domestic resource mobilization by the private sector are more difficult to interpret. Much of the industrial investment is financed by bank loans using lines of credit furnished by donor agencies or credit allocations provided by the State Bank, rather than on the basis of domestic bank deposits. Foreign banks can increase their credit allocation by bringing in foreign exchange and depositing it in Pakistan. The National Development Finance Corporation (NDFC) and Bankers Equity Ltd. (BEL) can expand their credit ceilings through growth in domestic deposits, but most other financial institutions are not interested in expanding deposits because this raises costs but not credit allocations. Success in making loans can result, however, in a larger credit allocation.

Table 4

Economic Growth, Savings and Investment

	1978/83	1986/87
	(Percent of GDP)	
GDP at market prices (annual growth rate)	6.1	4.9
-Gross Investment	16.6	17.2
-Fixed Investment	14.9	15.6
--Private	5.6	6.3
--Public	9.3	9.3
Inventories	1.5	1.6
Domestic Savings	6.2	9.1
National Savings	12.7	15.0
-Public	2.2	0.3
-Private	10.5	14.7
--Remittances	6.5	6.4
Foreign Savings	3.7	2.2
National savings as share of gross domestic investment	77.4	96.1
Domestic Savings as share of gross domestic investment	37.3	58.1

Relatively small amounts of stock are issued on the stock exchanges in Pakistan. These stock offerings do not maximize the return to the company because the price is based on book value rather than on the demand for the shares and the expected rate of return. As a result, share prices usually rise sharply immediately after issuance so that very large benefits accrue to the first time buyers rather than to the issuing companies. This practice and more questionable practices limit the effectiveness of the stock exchanges as a means for mobilizing capital.

E. Constraints to Increased DMR

The current government, although it was elected in fair nonparty elections, is reluctant to take unpopular measures such as tax increases (The martial law government used to justify its refusal to act on it not being an elected government and thus without popular support). The federal government currently collects about 20 percent or less of what it should be collecting in income tax. The corruption associated with this tax evasion benefits large industrialists, professionals, tax collectors, traders and almost every influential person in Pakistan. Income arising from agriculture, regardless of the amount involved is exempt from income tax. This exemption provides another reason why government has not acted to increase taxes, the argument being that since income from agriculture is not taxed, why should the rest of the country pay even more. The national and provincial assemblies are dominated by land owning interests who are unwilling to tax themselves. The Prime Minister recently withdrew a tax bill by agreeing that small traders will not be taxed on more than Rs.50,000 income ($2,900) and that the income liable for tax would not increase. The traders had carried out a strike and threatened the Prime Minister by reminding him that they had been responsible for the downfall of the Bhutto government, which led to Zia's martial law and Junejo's non-party government. The result of the above situation is a narrow base of taxpayers compared with a much larger group of potential taxpayers.

The information for recommending DRM measures is rapidly increasing. Several years ago the ADB carried out a study of the financial sector and recently sponsored another. The World Bank and the Asian Development

Banks are developing industrial credit loans that may have conditionality associated with the financial sector. As part of project preparation, the World Bank is carrying out a study of the financial sector, which was completed in January 1988, but has not been released. Furthermore, the World Bank assisted the government in the selection of consultants to help with the analysis of specific revenue measures. USAID is about to undertake a study of local government administration and financing that will identify sources of revenue at the district level and below (there are approximately 92 districts in Pakistan and they are the major administrative units below the provinces). The National Taxation Reform Commission published its final report January, 1987 which has been reviewed by various parliamentary committees, but significant legislative proposals have yet to come out of the study. The proposals submitted in the June, 1987 budget called for a number of measures, but none were measures recommended in the NTRC report. The public outcry that resulted, especially in the National Assembly, caused almost every revenue increase to be withdrawn. The government had to take a meat axe approach to cutting expenditures in order to keep the deficit under control. The National Finance Commission soon will release its report on how to allocate revenues between the central government and the provinces--it may contain revolutionary suggestions.

F. The USAID Strategy

The USAID strategy in the past was to support multilateral institutions that took the lead in DRM discussions while we attempted to increase user charges, reduce subsidies and encourage private investment through our various projects. The strategy presented here is broader in an attempt to achieve the subobjectives listed above in Section B. The USAID effort falls into three categories: (1) reduction in subsidies and other current expenditures and increases in user charges; (2) larger tax revenues; and (3) improvement in the financial sector. Each of these will be addressed in turn.

1. <u>Reduction in Subsidies and Other Government Expenditures and Increases in User Charges</u>

USAID will continue its effort to reduce subsidies and unnecessary government expenditures as a means of limiting the budget deficit. The major subsidies that we considered were wheat, fertilizer, irrigation water, electricity for tubewells and edible oil. Success has been achieved in the edible oil sector ($ 30 million), primarily because world prices fell. About one-third of the wheat subsidy has been eliminated (a savings of about $ 50 million), largely because of studies sponsored by USAID. Our program over the next few years will attempt to eliminate the remaining subsidy on wheat consumption by increasing the spread between the procurement price and the wholesale issue price, which now are identical. Success will reduce the drain on the budget in the short run, while inducing the private sector to enter the grain storage business, thus reducing the burden on government for additional storage capacity in the long run.

The subsidy situation for fertilizer has improved. USAID was successful in reducing factors such as incidentals related to the subsidized distribution of fertilizer by the public sector. Not only were these subsidies removed, but the overall subsidy on the production and distribution of nitrogenous fertilizer was eliminated for a total savings of perhaps $ 30 million. Less success was experienced in phosphatic fertilizer where the retail price is approximately one-half of the cost of imported fertilizer. Although the government has agreed to a schedule with the ADB to phase out the current subsidy of $ 90 million over a four year period, increases in world prices may make this schedule ineffective. Therefore, USAID will work through the Agriculture Sector Support Project (ASSP) and the overall policy dialogue to bring about a steady reduction of these subsidies.

USAID has only recently drawn its attention to subsidies on irrigation water. During the last six years, we have concentrated on quantifying the level of needed O&M expenditures and persuading the provinces to increase expenditures to the level necessary for long term efficient and equitable operation of the irrigation system. The World

Bank and ADB have concentrated on urging increases in water charges so they cover O&M cost. Thus far they have been unsuccessful, but we will join in the effort. Our proposed strategy is to increase rates for canal sub-commands that have been rehabilitated and now are working more effectively. The probable amendments to the parallel financed USAID and World Bank irrigation rehabilitation projects may call for funding cut-offs if rates are not increased.

The subsidy on tubewells results in excessive and inefficient use of water and excessive use of electricity at a time when electricity shortages are reducing output and employment. The USAID contribution has been to carry out studies on the cost of providing electricity to various classes of customers. The World Bank has taken the lead on overall electricity pricing, while USAID has concentrated on the structure of rates. We are particularly concerned about the factors that affect conservation. For example, domestic consumption is growing very rapidly, to a large degree because of rapid increases in the use of airconditioners made possible by residential rates that are lower than industrial rates. A very low rate for tubewells encourages the conversion of diesel powered pumps to electric pumps. The electric pumps are no more efficient on an energy basis and deprive industry of electricity. USAID has not used any of its project funds for rural electrification because the shortage of generation capacity would be exacerbated with little growth in economic output. In addition, WAPDA has not completed a master plan for rural electrification that would maximize the benefit-cost ratio.

USAID also will continue to urge the Government of Pakistan to reduce expenditures that are unessential in carrying out its activities. For example, we have provided assistance to examine the issue of public sector agencies raising funds commercially rather than depending upon the government budget. The effort to move agencies completely off the budget will continue. For example, it will be a major topic for discussion in the 1988 Economic Policy Review. The Government recently announced plans to move the Telephone and Telegraph Department off-budget and make it an autonomous organization. USAID will attempt other ways to reduce public expenditures such as the promotion of power generation in the private sector and private commercial health services. We have been doing exploratory work in the area of toll roads to be built by the private sector and financed by user charges.

USAID together with other major donors has been encouraging the government to increase charges for electricity, gas and irrigation water. For example, the Energy Commodities and Equipment project has a condition calling for self-financing (based on user charges) of 40 percent of the expansion costs of electricity supply. User charges are a way to reduce subsidies for government services on public sector enterprises, which reduces government expenditures. User charges not only encourage more economic use of services but also could be a way of collecting revenues in a society that does not pay very much in taxes. We also have tried to increase user charges for health services and higher education, so far without success. This is an area where we will continue to devote attention.

2. Tax Revenues

USAID and other donors have not asked the government to raise tax rates. In fact, the government reduced income tax rates in an effort to increase the number of companies and persons that declare their entire income. The success of this effort has been rather limited in terms of growth in tax revenues. The World Bank has been carrying on a policy dialogue about the need for additional taxes and some progress is expected by July 1988. USAID is about to initiate a study of local government administration and financing that will attempt to identify and quantify additional revenues that could be raised at the sub-provincial level. USAID will carry on a policy dialogue in this area and will attempt to support the efforts of the World Bank. We also will be responsive to GOP requests for technical assistance in the tax field.

3. Improvements in the Financial Sector

USAID has been calling for additional private financial institutions for the last two or three years. We first became familiar with the sector as a result of an attempt to establish a private investment company. Since then the government has issued regulations for such companies but has not yet implemented this policy. We will continue to work with the government through our policy dialogue to bring it about. These companies have the potential to mobilize much higher levels of savings and match them with productive investment. Unfortunately, illegal companies that have absconded with deposits are souring the environment for possible legal companies.

Commercial banks often do not seek deposits because they cannot make additional loans and must invest their excess funds in government securities that pay lower returns than the cost of deposits. USAID may sponsor research on this issue.

USAID has also been talking to the government about financing public sector agencies through capital issues in the financial market. We brought out officials from the Federal Reserve System to work with State Bank of Pakistan officials on this issue; their advice was important for the issuance of bonds by WAPDA. We expect to do much more in moving public sector enterprises off the budget. Another activity still under consideration is privatization, which has the potential for increasing DRM in the private sector.

USAID just completed a study of the adequacy of rural credit. We expect to follow it with a policy dialogue and perhaps additional studies or a project if justified. Counterpart funds might be used to correct deficiencies. The Mission has been investigating the housing financial sector and has brought out several teams. A Housing Investment Guarantee program may be implemented, but only in conjunction with new private financial institutions. Our work on private sector power is as much a financing project as an energy project. One objective is to mobilize more resources through the private sector than the government could accomplish. We also are investigating the potential for toll roads in which the private sectors would mobilize the financial resources.

The USAID effort in DRM is very broad, cutting across all the sectors in which we have projects and interests. Conditions precedent and policy dialogue are the major tools for bringing about change. We may have a few specific projects in which DRM is at the heart, but they will be listed as energy, housing, health, etc. projects. A small possibility exists that DRM might be associated with policy based cash transfers.