

ECONOMIC ANALYSIS

A. Introduction

1. The proposed additional financing aims to augment the scope of the ongoing Social Protection Development Project to help the government enhance social assistance under the Benazir Income Support Program (BISP). The BISP is Pakistan's nationwide program providing unconditional cash transfers (UCTs) to eligible poor females and their families since 2008. Disbursements under the BISP increased from 0.28% of gross domestic product (GDP) in fiscal year (FY) 2014 (ended June 2014) to 0.32% of GDP in FY2019.

2. UCT programs aim at reducing poverty and vulnerability by providing direct cash payments to financially disadvantaged people without any conditionality. In the case of cash transfers, many important economic benefits, such as the impacts on welfare and intergenerational effects, cannot be directly quantifiable. Moreover, it is difficult to assess the project's full returns through conventional economic and financial analyses, because of the nature of UCTs and the project's contribution to national social protection reforms.

3. The economic gains of the project come from project outputs that focus on supporting the BISP for continued UCT payments, strengthening institutional capacity for improved financial management and control systems, and strengthening policy research functions for better decision-making.

4. The project's expected benefits in the short term include the effect on income and consumption-related poverty and vulnerability; in the longer run it is expected to have broader socioeconomic impacts through human capital buildup. The improved efficiency of government programs will promote sustainable service delivery to the poor. The BISP is the country's primary safety net mechanism to provide minimum income support. Therefore, cost-effectiveness analysis comparing various mutually exclusive, technically feasible project alternatives to select the least-cost option was not considered viable for this analysis.

B. Poverty and Vulnerability in Pakistan

5. Pakistan has made significant progress in lowering consumption-based poverty and inequality. Between 2001–2015, the consumption poverty rate declined from over 50.4% to 24.3%. Multidimensional poverty considers wider dimensions to measure poverty and development progress; according to this definition, which encompasses the various deprivations experienced by poor people in their daily lives such as poor health, lack of education, inadequate living standards, disempowerment, poor quality of work, the threat of violence, and living in areas that are environmentally hazardous, about 38.8% of the population is still poor. There are stark regional and urban–rural disparities, with a poverty rate of 54.6% in rural areas and 9.4% in urban areas.¹

6. On the Human Development Index, Pakistan was ranked 150th of 189 economies in 2017,² lower than India, Bangladesh, and Sri Lanka. This low ranking reflects the generally low human resources and skills development in Pakistan, which has resulted in a lower level of

¹ ADB. Forthcoming. *Islamic Republic of Pakistan: Country Diagnostic Study*. Manila.

² United Nations Development Programme. 2018. [Human Development Indices and Indicators: 2018 Statistical Update](#). New York.

competitiveness and productivity. Limited fiscal space because of low levels of domestic savings and revenue collection restrict public spending on social sectors such as health and education. During FY2014–FY2017, total expenditure on education averaged 2.1% of GDP and total expenditure on health averaged 0.8% of GDP. The gender gap remains a key challenge in Pakistan because of limited progress in gender equality. Pakistan was ranked second to last, ahead of only Yemen, in the 2018 Global Gender Gap index.³ Female low educational attainment, poor health, and restrictive social norms lead to a very low female labor force participation and wage rate. According to one estimate, if Pakistan can close the gender gap, its GDP would increase significantly through an increased workforce, and higher output and productivity.⁴

7. Existing social safety nets have impacted poverty and vulnerability, but their coverage is still limited. The income support to female-headed impoverished families through the BISP has helped reduce consumption-based poverty. The UCTs to eligible families increased by 66% during FY2014–FY2018. The BISP budget has increased by more than threefold since its inception in 2008 but covers only about 45% of the country's poor population (footnote 3). An impact evaluation of the BISP from February to May 2016 using a “cost of basic needs” poverty line method shows that it has helped reduce the poverty gap by 3 percentage points.⁵

C. Macroeconomic Challenges and Reforms

8. As macroeconomic challenges reemerged in 2018, the government initiated various stabilization measures through tighter monetary and fiscal policies and moved toward a flexible exchange rate policy. Since early 2018, a sharp depreciation in the exchange rate (by nearly 50%) against the dollar, gradually increasing tariffs for gas and electricity, and a more than doubled policy rate by the State Bank of Pakistan have contributed to inflationary pressures. Under a 3-year International Monetary Fund (IMF) program starting in July 2019, the government agreed to undertake difficult reforms up front.⁶ These reforms are expected to slash GDP growth by one-third (to 2.4%) and raise inflation to 13% in FY2020, reflecting a significant increase in utility prices and indirect taxes. A strong pressure from cost-push inflation is likely to significantly erode the purchasing power and welfare of the common person through economy-wide impacts.

D. Program Impact and Benefits

9. The countercyclical policies aimed at demand management negatively impact income and consumption as economic activity slows down. The social cost of adjustment is expected to be high for the poor and vulnerable: a 2008 Asian Development Bank study estimated that a 10% increase in food prices would result in an additional 7.05 million poor people in Pakistan.⁷ Weak growth prospects indicate economy-wide impact, including a higher rate of unemployment given the strong relationship between growth and employment in Pakistan. Recent data on income distribution for Pakistan suggest that the income share of the poorest 20% of the population fell from 9.8% to 5.9% during FY2013–FY2016—the period when a previous IMF program was implemented (footnote 1). The government initiated the Ehsaas poverty alleviation

³ World Economic Forum. 2018. [The Global Gender Gap Report 2018](#). Geneva.

⁴ International Monetary Fund (IMF). 2018. [Pursuing Women's Economic Empowerment](#). Washington, DC.

⁵ Oxford Policy Management. 2016. [Benazir Income Support Programme: Final Impact Evaluation Report](#). Oxford.

⁶ IMF's Executive Board approved the Extended Fund Facility of \$6.2 billion in its meeting held on 3 July 2019.

⁷ Asian Development Bank. 2008. [Food Prices and Inflation in Developing Asia: Is Poverty Reduction Coming to an End?](#) Manila.

program in April 2019 to reduce inequality, invest in human capital, and lift up lagging districts. Under this program, the government has allocated an additional PRs80 billion in social protection spending in the budget for FY2020, and PRs120 billion for FY2021. However, meeting the government's budgetary targets relies largely on enhancing revenue collection, which may be a challenge in a low-growth scenario.

10. The UCT programs are generally designed to provide a necessary cushion against short-term shocks as a result of ongoing and planned reforms. To this effect, the additional financing will complement government efforts not only to address immediate challenges but also to maintain these initiatives on a sustained basis as the economy recovers from its current macroeconomic situation. The project will contribute to government's plan to enhance cash transfers through quarterly disbursement by 10% for each eligible family. UCTs may not have a large impact on poverty reduction, but they carry significant benefits for the chronic poor who are currently being supported by the BISP. These benefits include increasing incomes, increasing consumption of critical goods and services, and breaking intergenerational poverty traps by encouraging increased investment in human capital in the long run. Moreover, amid limited access to formal sources of credit for the rural as well as urban poor, predictable inflows can help smooth consumption while enhancing the ability to address vulnerabilities and shocks to income.

11. Investment in social protection is difficult to quantify but can yield fiscal savings for the government in the medium to long term. As the poorest households become more resilient to shocks, build their human capital, and are able to improve their employment potential, their need for government support lessens. In the short term, resources spent through the cash transfer program of the BISP can have important positive multiplier effects, and could result in additional tax revenue. Further, the households falling in the lowest income quintile typically spend most of their monthly income on food, rent, fuel, and lighting. The initial economic impact analysis estimates suggest that this additional financing is expected to contribute about \$850 million to Pakistan's GDP through the direct and follow-on supply chain impacts.⁸ This directly supports the government's objective of moving to a higher economic growth trajectory by pursuing shared prosperity.

12. Weak institutional capacity and financial management systems in the public sector, despite gradual improvements, remain a key governance challenge in Pakistan. The BISP is, however, one of the public sector programs that are subject to regular evaluation, although there is need for improvement in several areas. Efficiency gains from improved financial management will come from the program output that includes enhanced monitoring and evaluation, including through increased awareness of beneficiaries, policy research for evidence-based programs, establishment of a data hub for better targeting of social welfare benefits, and better linking of social protection and labor market policies. This will help the government to develop more efficient and cost-effective social protection programs targeting, which target the the root causes of poverty such as low human development and which can result in sustained escapes from poverty and move families out of the intergenerational poverty trap.

⁸ The expenditure-to-GDP multiplier is estimated to be large at 5 for Pakistan, given the consumption-driven nature of the economy. This multiplier is estimated through Keynesian economic theory and is based on the marginal propensity to consume (MPC) methodology. The average long-run MPC ratio is estimated to be 0.8, which is calculated as the ratio of yearly change in household consumption and yearly change in GDP during FY1980–FY2019. The GDP multiplier is estimated using the formula of $1/(1-MPC)$.

13. Investment in human capital, in the long term, will contribute to raising productivity and growth as well as higher employment and incomes. Low primary school enrollment rates and high secondary school dropout rates in Pakistan are also determined by low income levels. Cash transfers that support household income affect parents' decisions regarding their children's schooling, since children who would otherwise be forced to work to support the family could attend school instead. High malnutrition in infancy and childhood in Pakistan accompanied by permanent cognitive impairment, decreased learning, and physical stunting has a negative impact on average individual productivity in adulthood. Better nutrition for women and children will contribute to improved maternal health and cognitive development of children and encourage higher enrolment rates and lower dropout rates. Prevention of stunting also means children can better capitalize on opportunities presented by education and skills training, be more productive, and contribute more to the economy.

D. Conclusion

14. The comprehensive social protection framework is aimed at overcoming the challenges of poverty, health, stunted growth, and education, and would enable the youth to realize their potential and extricate themselves out of intergenerational poverty traps. Sustainable Development Goals have been widely regarded as the best vehicle to address poverty alleviation in Pakistan. The government is planning to establish enough social protection for all marginalized and vulnerable segments of the society. The BISP will help the government in achieving this objective with continued support from development partners. The additional financing aims to facilitate the government's efforts to augment fiscal space for critical development expenditures. The government is taking the necessary steps to support the poor in line with the Ehsaas program.